S. Hrg. 100-152

REVIEW OF THE REVENUE INCREASES PROPOSED IN THE PRESIDENT'S BUDGET

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

MARCH 23, 1987

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
73-591 WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S361-37

COMMITTEE ON FINANCE

LLOYD BENTSEN, Texas, *Chairman*

SPARK M. MATSUNAGA, Hawaii	BOB PACKWOOD, Oregon
DANIEL PATRICK MOYNIHAN, New York	BOB DOLE, Kansas
MAX BAUCUS, Montana	WILLIAM V. ROTH, Jr., Delaware
DAVID L. BOREN, Oklahoma	JOHN C. DANFORTH, Missouri
BILL BRADLEY, New Jersey	JOHN H. CHAFEE, Rhode Island
GEORGE J. MITCHELL, Maine	JOHN HEINZ, Pennsylvania
DAVID PRYOR, Arkansas	MALCOLM WALLOP, Wyoming
DONALD W. RIEGLE, Jr., Michigan	DAVID DURENBERGER, Minnesota
JOHN D. ROCKEFELLER IV, West Virginia	WILLIAM L. ARMSTRONG, Colorado
TOM DASCHLE, South Dakota	

William J. Wilkins, *Staff Director and Chief Counsel*
Mary McAuliffe, *Minority Chief of Staff*

Subcommittee on Taxation and Debt Management

MAX BAUCUS, Montana, *Chairman*

SPARK M. MATSUNAGA, Hawaii	JOHN H. CHAFEE, Rhode Island
DANIEL PATRICK MOYNIHAN, New York	WILLIAM V. ROTH, Jr., Delaware
DAVID PRYOR, Arkansas	JOHN C. DANFORTH, Missouri
	MALCOLM WALLOP, Wyoming

CONTENTS

PUBLIC WITNESSES

Page
Shapiro, Florence, Council Member, Plano, TX, and Vice President, Texas Municipal League, on behalf of the National League of Cities 4
Farrand, Chris, Vice President for Government Relations, Peabody Co., on behalf of the National Coal Association 14
Dempsey, William H., President of the Association of American Railroads, accompanied by Charles I. Hopkins, Jr., Chairman, National Railway Labor Conference 25
Bates, R.T., chairman, Railroad Retirement Committee 51
Grisanti, Michael J., Vice President and Chief Executive Officer, Grisanti, Inc., on behalf of the National Restaurant Association 58
Burhop, William, Senior Vice President, Government Affairs, on behalf of the Air Transport Association of America 68
Willis, Frank E., Willis Construction, on behalf of the Associated General Contractors of America, accompanied by John R. Gentille, director, Highway Division, AGCA 80
Vaughn, Eric, President and Chief Executive Officer, Renewable Fuels Association 90

ADDITIONAL INFORMATION

Committee press release 1
Prepared statement by Senator Max Baucus 2
Prepared statement of Ms. Florence Shapiro 7
Prepared statement of Chris Farrand 16
Prepared statement of William H. Dempsey and William I. Hopkins, Jr 27
Prepared statement of R.T. Bates 52
Prepared statement of Michael Grisanti 60
Prepared statement of William J. Burhop 71
Prepared statement of Frank E. Willis 82
Prepared statement of Eric Vaughn 92

COMMUNICATIONS

American Bus Association 109
American Council on Education 113
American Hotel & Motel Association 116
Government Finance Officers Association 122
Engineers & Architects Association 125
National Association of Towns & Townships 129
National Conference of State Legislatures 138
National Education Association 143

REVIEW OF THE REVENUE INCREASES PROPOSED IN THE PRESIDENT'S BUDGET

MONDAY, MARCH 23, 1987

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
COMMITTEE ON FINANCE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:31 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Max Baucus (chairman) presiding.

Present: Senators Baucus and Daschle.

[The press release announcing the hearing and the opening statement of Senator Baucus follow:]

[Press Release No. H-24, March 5, 1987]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARING ON ADMINISTRATION TAX PROPOSALS

WASHINGTON, DC.—Senator Max Baucus (D., Montana), Chairman of the Subcommittee on Taxation and Debt Management, announced today that the Subcommittee will hold a hearing on March 23, 1987, to review the revenue increases proposed in the President's budget.

"The Committee on Finance has jurisdiction over about $6 billion of the $22.4 billion of tax and other revenue increases proposed by the President," Senator Baucus said.

"On February 4, 1987, the Committee heard testimony from Administration witnesses who explained the President's proposals. It is important that the Committee now hear from those who would be affected by the proposals to evaluate whether the President's suggestions are sound proposals to help achieve the deficit reduction targets that will be established by the Congressional budget process," said Baucus.

The hearing will begin at 9:30 a.m. on Monday, March 23, 1987 in Room SD-215 of the Dirksen Senate Office Building.

STATEMENT BY SENATOR MAX BAUCUS
TAXATION AND DEBT MANAGEMENT SUBCOMMITTEE
March 23, 1987

The Budget Process

The subjects of today's hearing are the revenue-raising proposals in the President's budget.

Let me describe where things stand.

For more than a month, we've been holding hearings about trade and competitiveness. These hearings have reminded us that deficit reduction must be an important element of any strategy to restore America's international competitiveness. Witness after witness has testified that an important cause of our trade deficit is our budget deficit.

But, as Shakespeare said, "words pay no debts." To significantly reduce the budget deficit, it will take more than good intentions. It will take yet another gut-wrenching package of spending cuts and tax increases.

The President's Package

The President's budget proposes a miscellaneous collection of tax increases that would raise about $6 billion in fiscal 1988.

However, the Congressional Budget Office estimates that the President's budget is based on overly optimistic economic assumptions. This creates the possibility that an even larger revenue increase will be necessary in order to achieve our budget target.

We've all seen articles indicating that the budget resolution may require a revenue increase of as much as $18 billion in 1988. To put this in perspective, the 1984 Deficit Reduction Act only raised revenue by $10 billion its first year of operation.

So we may have our work cut out for us. Nobody likes to raise revenue. But this Committee will, as always, do all it possibly can in order to meet the overall obligations established by the Congressional budget process.

Today's Hearing

The Administration proposals are a starting point. On February 4th, Assistant Secretary Mentz and other officials testified in support of the President's proposals.

Today's hearing is designed to provide groups that would be affected by these proposals an opportunity to make their case to the Committee. As the debate unfolds and the Finance Committee's obligations become more defined, it may be necessary to hold further hearings and consider further options.

I would like to remind our witnesses that we have a long agenda and many subjects to cover. Please summarize your statement in five minutes or less. Your full written statement will be included in the hearing record.

Senator BAUCUS. The Subcommittee on Taxation and Debt Management will come to order.

The subjects of today's hearing are the revenue-raising proposals in the President's Budget. For more than a month we have been holding hearings about trade and competitiveness. These hearings have reminded us that deficit reduction must be an important element of any strategy to restore America's international competitiveness. Witness after witness has testified that an important cause of our trade deficit is our budget deficit. But, as Shakespeare said, "Words pay no debts." To significantly reduce the budget deficit, it will take more than good intentions; it will take yet another gut-wrenching package of spending cuts and revenue increases.

The President's budget proposes a miscellaneous collection of tax increases that would raise about $6 billion in fiscal 1988. However, the Congressional Budget Office estimates that the President's budget is based on overly optimistic economic assumptions, creating the possibility that an even larger revenue increase will be necessary in order to achieve our budget target.

We have all seen articles indicating that the budget resolution may require a revenue increase of as much as $18 billion in fiscal 1988. To put this in perspective, the 1984 Deficit Reduction Act only raised revenue by $10 billion in its first year of operation. So, we may have our work cut out for us. Nobody likes to raise revenue, but this committee will, as always, do all it possibly can in order to meet the overall obligations established by the Congressional budget process.

The Administration's proposals are starting points. On February 4 of this year, Assistant Secretary Mentz and other Administration officials testified in support of the President's proposals. Today's hearing is designed to provide groups that would be affected by these proposals an opportunity to make their case to the committee and to the Congress.

As the debate unfolds, and the Finance Committee's obligations become more defined, it may be necessary to hold further hearings and consider further options.

I would like to remind our witnesses that we have a long agenda and many subjects to cover. I therefore ask each witness in five minutes to summarize his or her statements.

The first panel is Florence Shapiro, Council Member, Plano, Texas, and Vice President of the Texas Municipal League; and also Chris Farrand, Vice President for Government Relations, Peabody Holding Company.

Chris and Florence, why don't you both proceed, and, Florence, why don't you begin?

STATEMENT OF FLORENCE SHAPIRO, COUNCIL MEMBER, PLANO, TX, AND VICE PRESIDENT, TEXAS MUNICIPAL LEAGUE, ON BEHALF OF THE NATIONAL LEAGUE OF CITIES

Ms. SHAPIRO. Good morning, Mr. Chairman.

I would like to submit my testimony for the record. I am Florence Shapiro, Council Member from the City of Plano, Texas, and I am here this morning representing the National League of Cities, the largest and oldest organization in the country of public elected officials of the nation's cities and towns. I am grateful for the opportunity to appear before you to discuss our reactions to the Administration's Proposed Federal Tax Increases. These proposals would have a disproportionate impact on the municipalities. They would mandate increased local spending.

We understand and are sympathetic with your efforts to reduce the federal deficit; we are opposed, however, to proposals which simply transfer debt problems to other levels of government. We urge you in the strongest terms to prevent any further erosion of the constitutional concept of reciprocal immunity and to reject any proposals which would impose or mandate federal taxes for state and local governments.

For 200 years this nation has evolved a federal system in which one level of government may not tax another. Now the rules are beginning to change, but they are only changing for one player—the Federal Government. Proposals to impose direct federal taxes on state and local governments are an indirect tax on all American taxpayers, but the impact is to impose greater burdens on state and local governments and to do damage to our roles and responsibilities as public elected officials.

There are two tax proposals which would come under the jurisdiction of this committee which most directly concern and impact municipalities: Mandatory Medicare, and Mandatory Federal Gas Taxes for State and Municipal Vehicles.

Mandatory Medicare proposes that all municipalities and their employees should be required to contribute to the Medicare Trust Fund. This committee resolved this issue more than a year ago, when the Congress adopted legislation to phase in mandatory Medicare. Having disposed of the issue, it is now at your back door again.

As proposed by the Administration, the mandatory Medicare provision would take place in the middle of most state and municipal budget years. We anticipate that few if any cities or towns would have the flexibility to abruptly alter current medical benefit and retirement programs. Therefore, the only alternatives in most cases would be to increase property taxes or cut necessary expenditures. This has several negative consequences:

First is an immediate pay reduction for individual employees equal to 1.45 percent. For an employee making $20,000 a year, that translates into a $300 per year or $25 per month in reduced take-home pay. In the case of the City of Plano, Texas, over $400,000 would be taken out of our employees' pockets and out of the local economy. As another example, in the City of Fort Worth, Texas, that cost would be in excess of $1.7 million.

Second is a dramatic increase in city operating expenditures. For the City of Plano alone, this proposal would be over $400,000 in employer-share takes. We would be faced with the option of raising our tax rates .06 cents, approximately a 1.3 percent increase, or over half a penny on the tax rate; or, the other option of letting each department reduce its budget an appropriate amount. Departments with large numbers of personnel such as police and fire would be most adversely affected by a budget cut such as this. The bottom line is that our employees and our taxpayers would have to shoulder the full burden of this proposal on a very sudden basis.

This could, we fear, have an adverse impact on employee morale in addition to the clear economic impact upon our community.

The phase-in program of last year, we feel, has a reasonable transition period, because the law passed last year requires that new employees be covered. We believe that the goals for this particular proposal can and will be accomplished in a reasonable amount of time.

President Reagan's budget proposes the repeal of the longstanding exemption for state and local vehicles from the 9 cents per gallon federal motor vehicle fuels tax. This repeal will force every city in the nation to choose between reducing service levels or increasing taxes.

Unfortunately, the service-level areas, which will be the hardest hit, use the highest amount of fuel. In the City of Plano alone, we consumed 382,000 gallons of gasoline and 138,000 gallons of diesel in 1986 Based on these numbers, we would have to increase taxes by $55,000. If this proposal becomes law, Plano and every other city in the nation will be forced to raise local taxes to pay federal taxes. We urge you to prevent this from occurring.

If the policy is that every vehicle using our national highway system should pay user taxes, then it should apply to all vehicles. We think that you should listen to the impact that that would have, from our perspective, on federal vehicles as well.

In summary, Mr. Chairman, we are sympathetic with your efforts to reduce the federal deficit and to ensure fairness in all federal programs. However, we do not believe that the Administration's proposal to tax municipal consumption of gasoline, nor their proposal to abandon their goal of gradually phasing in mandatory Medicare coverage is the way to accomplish this. Thus, we hope the committee will reject these proposals.

Thank you.

Senator BAUCUS. Thank you very much, Florence.

Chris?

[Ms. Shapiro's written prepared testimony follows:]

STATEMENT
OF
FLORENCE SHAPIRO, COUNCILMEMBER, PLANO, TEXAS
FOR THE
NATIONAL LEAGUE OF CITIES
MARCH 23, 1987

Good morning, Mr. Chairman and members of the Committee. My name is Florence Shapiro. I am a Councilmember in Plano, Texas, and I am here this morning representing the National League of Cities--the largest and oldest organization in the country of publicly elected officials of the nation's cities and towns.

I am grateful for the opportunity to appear before you to discuss our reactions to the administration's proposed federal tax increases which have been submitted to the Congress as part of its budget proposals. These proposals would have a disproportionate impact on municipalities. They would mandate increased local spending, and they would disrupt our own budget processes.

We would strongly urge you to reject any proposals which would impose or mandate federal taxes on state and local governments. Such forms of taxation do harm to the Constitutional concept of recripocal immunity.

For two hundred years this nation has evolved a federal system in which one level of government may not tax another. Now the rules are beginning to change, but they are only changing for one player: the federal government.

We believe that any consideration of taxing ought to be reciprocal. That is, if the federal government wishes to impose a tax on municipal bonds, then state and municipal governments ought to be permitted to tax federal bonds and securities. If the federal government wishes to impose a federal tax on state and municipal vehicles, then states and municipalities ought to be permitted to impose state and local gasoline and other vehicle taxes on federal vehicles.

Proposals to impose direct federal taxes on state and local governments are an indirect tax on all American taxpayers. But the impact is to impose greater burdens on state and local governments and to do damage to our roles and responsibilities as public elected officials.

There are two tax proposals which would come under the jurisdiction of this Committee which most directly concern and impact municipalities: mandatory Medicare and mandatory federal gas taxes for state and municipal vehicles.

Medicare

The proposal that municipalities and their employees should be required to contribute to the Medicare trust fund is one which this committee resolved more than a year ago when the Congress adopted legislation to phase in mandatory Medicare.

Having disposed of the issue, it is now back at your door. As proposed by the administration, the mandatory Medicare provision would take place in the middle of most state and municipal budget years.

It makes no provision for how cities, with their budgets already in place, can make the transition from current health insurance systems to one mandated by the federal government. We anticipate that few, if any, cities or towns would have the flexibility to abruptly alter current medical benefit and retirement programs. Therefore, the only alternatives in most cases would be to increase property taxes or cut necessary expenditures.

In my city, for instance, mandatory Medicare would cost approximately $400,000. In Plano, such an increase would require us to identify an offsetting municipal revenue or tax increase.

The bottom line is that our employees and our taxpayers would have to shoulder the full burden of this proposal on a very sudden basis. This could, we fear, have an adverse impact on employee morale, in addition to the clear economic impacts upon our community.

I must add that this proposal comes at a time when municipalities have already been asked to bear disproportionate burdens. Our priority programs have been cut over 66 percent, while the federal deficit has skyrocketed. At the same time we have been asked to take such deep cuts, we have been required to assume major new financial responsibilities in the form of federal mandates. Meanwhile our own flexibility to raise revenues and borrow has been limited under tax reform.

We are prepared to support serious, constructive efforts to help reduce the federal deficit. We are opposed, however, to proposals which simply transfer debt problems to other levels of government which have relied in good faith on existing federal law and commitments.

There are, in fact, many state and local governments which have proceeded in good faith to develop and administer retirement systems which rely in part on the federal Medicare and Social Security systems. But when the federal government terminated the right of states and municipalities to voluntarily withdraw from Social Security and Medicare in 1983, it specifically precluded the federal government from preempting the rights of states and local governments to retain their own pre-existing health insurance and retirement systems. We do not understand what has changed since the bipartisan Social Security Commission made its recommendations. Therefore, we can't understand the rationale for the administration's proposal.

Finally, on this issue, Mr. Chairman, the administration has attempted to justify this federal tax on the basis of reports that perhaps as many as 75 percent of current municipal employees might be eligible for Medicare benefits without having paid in. We have seen no such data. But we presume there are many non-state and municipal employees who will also be eligible because of their spouse.

If the federal policy is to be that all who might someday be eligible must contribute, then the policy should be structured in a non-discriminatory way to achieve that goal. That goal--and more--has already been achieved for cities under actions already set in the law.

Federal Gas Taxes

The administration has also proposed to repeal the exemption from federal excise taxes for state and municipal vehicles. This federal tax increase will force cities and towns to increase their own taxes in order to maintain current services for essential public services, including police, fire, emergency rescue, and school bus transportation.

Cities do not have the alternative of cutting back on fuel use consumption or the purchase of trucks or other vehicles and parts: to do so would jeopardize the lives of our constituents.

This is a proposed federal tax increase which will produce one certain result: it will increase the cost of the most important services we provide to the American people.

This administration proposal strikes us as especially discriminatory. It includes no similar repeal for federal vehicles, nor does it contain any proposal to permit states and local governments to levy "user fees" or local gas taxes on federal vehicles which use our own streets and highways.

Although there has been some attempt to justify this newly proposed federal tax increase as a user fee, we note that the new taxes are not even proposed to come back to us through the federal Highway Trust Fund. Rather they are counted solely for the purpose of deficit reduction.

If the policy is that every vehicle using our national highway system should pay user taxes, then it should apply to all vehicles--not just private, state, and municipal--and cities should have exactly the same right to tax federal vehicles which use our own streets and highways--the majority of which were constructed without funds from the Federal Highway Trust Fund.

We think that if you measured the impact on the federal budget of mandating that every federal vehicle pay the federal gas tax, it would give you some idea of our perspective.

If the problem is that we need greater investment in our surface transportation infrastructure--that is, we need more spending on highways and bridges--then the administration should request such an increase. We note, however, that the administration's budget request would not even permit the nearly $1 billion in interest earned on surpluses in the Trust Fund to be used for the purposes intended by the Congress.

But, as the special assistant to the Assistant Secretary for Tax Policy told us at our Congressional-City Conference this month, "this is a revenue, not a highway issue."

The National League of Cities believes that federal transportation trust funds should be removed from the unified budget. Decisions on the appropriate level of funding--and taxing for the fund--ought to be made for the reasons intended by the Congress: the nation's transportation needs.

In summary, Mr. Chairman, we concur with the administration that the federal deficit cannot be reduced just by cutting spending, but we do not believe one level of government in this country ought to be in the business of taxing another level. Each of us has a difficult enough job in dealing with our own taxes and budgets. Thus, we hope this committee will reject these proposals.

STATEMENT OF CHRIS FARRAND, VICE PRESIDENT FOR GOVERNMENT RELATIONS, PEABODY HOLDING COMPANY, ON BEHALF OF THE NATIONAL COAL ASSOCIATION

Mr. **Farrand**. Thank you, Mr. Chairman.

My name is Chris Farrand. I am Vice President of Peabody Holding Company; I am here today representing the National Coal Association. I am also a member of the Task Force on Taxation of something called The Joint Interest Committee, which is a creature of the United Mine Workers and the Bituminous Coal Operators Association. I say that because the position I espouse today is also held by both management and labor.

We welcome the opportunity to comment on the President's budget proposals, with particular attention obviously to the proposed Black Lung Tax increase. It is going to come to no surprise to you that we strenuously object to that increase, which amounts to a 54 or 55 percent increase in the Black Lung Tax.

Mr. Chairman, you may recall that last year the Administration proposed a 50 percent increase in the Black Lung Tax, and Congress, recognizing I think the self-defeating nature of that proposal, chose instead to enact a 10 percent increase, coupled with a five-year deferral of interest payments on the indebtedness of the Black Lung Trust Fund.

We contend that that agreement is working, that we see the light at the end of the tunnel with all the clarity that the Labor Department projections provide for us, and that in fact we will attain operational solvency in the Fund in FY-1988.

Let me just give you a brief history of the program, if I may. It was established in 1969 as a supplemental disability program, essentially for pre-1970 coal mine employees who were alleged to have suffered from pneumoconeosis, or Black Lung. The post-1970 employees, by and large, are the responsibility of the coal operators and not the Trust Fund. In 1981, Congress felt that the eligibility rules for benefit applicants were too broad. They tightened those rules considerably and doubled the tax. The tax in 1981 went to 50 cents for a ton of surface coal, and a dollar for a ton of underground mined coal. Last year, of course, a 10 percent increase was imposed, making the current tax $1.10 for underground coal and $.55 for surface coal.

Now, of course, the Administration seeks a 55 percent increase coupled with repayment of interest and some changes in the benefits the program provides. That would leave the tax at $.85 for surface coal and $1.70 for underground coal.

The agreement is working. We will exceed our program costs—tax receipts of the program will exceed program costs—next fiscal year. By 1990, we will be repaying principal on the Trust Fund's indebtedness in the amount of $42 million. In 1991, Mr. Chairman, when the interest payments resume, we will see an increase in the indebtedness but at a declining rate for a period of about 10 years or until the year 2000. After that there will be a steady decrease in the amount of the indebtedness. Under current Labor Department projections, the indebtedness would be retired in about the year 2014. That contrasts, of course, with the expected date of the elimination of the indebtedness of 2007 under the Administration's proposal.

Mr. Chairman, our industry is under pretty intense pressure right now from both interfuel and international competition. We would have a very hard time withstanding a $350 million annual tax increase, which is what this proposal entails. It would obviously result in grave consequences to our competitiveness.

Simply stated, we urge the committee to reject the proposal. The goal of the agreement last year, the 1986 agreement, was to put the Black Lung Trust Fund on a sound financial footing. We think we have done that. The industry recognizes our responsibility to see the indebtedness eliminated; we intend to do that.

There is one slight problem I would like to mention, and that is that there was a drafting error last year which would let the tax level revert to its pre-1981 level in 1995. That was unintended. We fully expect the current tax level to remain in effect until the debt is retired, and we will seek an appropriate mechanism for correcting that drafting error. I will be happy to answer any questions you may have.

Senator Baucus. Thank you both very much.

[Mr. Farrand's written prepared testimony follows:]

NATIONAL COAL ASSOCIATION

Statement of

Chris Farrand
Vice President
Peabody Holding Company

before the

Taxation and Debt Management Subcommittee
of the
Senate Finance Committee
A Hearing on Revenue Increases Proposed in the
Administration's FY 1988 Budget

March 23, 1987

Mr. Chairman, I am Chris Farrand, Vice President of Peabody Holding Company, which through its subsidiaries, is the nation's largest coal producer. I am appearing on behalf of the National Coal Association, which represents the producers of the majority of the coal in the United States. We welcome the opportunity to present our position on the Administration's FY 1988 budget proposal as it pertains to the proposed increase in the Black Lung Excise Tax.

The coal industry strongly objects to the proposed tax increase which would raise the Black Lung Tax by 54.5 percent. The Black Lung Tax agreement enacted by the Congress last year is working as intended, and is a fair balance between the need to ensure the eventual solvency of the Black Lung Disability Trust Fund and the need to maintain a stable and viable domestic coal industry.

The Labor Department's Black Lung Disability Trust Fund was established by legislation in 1978 and financed by a producer's tax on each ton of coal mined in this country. It is liable for disability payments involving pre-1970 employment cases.[1] From its inception, the Fund has had to rely on advances from the Treasury to meet payments for disability and medical benefits, administrative costs and interest on the advances from the Treasury.

In 1981 the tax was doubled and eligibility standards were tightened for new applicants. In 1986 the tax was further raised from a $1.00 per ton for underground mined coal and $.50 per ton for surface mined coal to $1.10 and $.55 respectively.

In FY 1988, the Labor Department projects that receipts will exceed program costs, including all benefits and administrative costs (attached). However, debt service on the accumulated debt of the Trust Fund to Treasury currently is over $275 million.

The President's FY 1986 budget proposed a 50 percent increase in the excise tax to make up for these interest costs.

Last year, Congress recognized the self-defeating nature of this proposal -- higher excise taxes that further depress production, particularly in a period of intense interfuel competition, leading to lower Trust Fund receipts than projected, more borrowing, and further postponement of the time that the Fund would reach solvency. As a compromise agreement, Congress increased the tax by 10% and forgave five years of prospective interest on the accumulated debt.

That agreement is working. According to recent DOL estimates, receipts from the fund will be repaying about $42 million in principle by 1990. When interest costs are resumed in 1991 the accumulated debt of the fund will temporarily increase. However, steadily increasing receipts and decreasing expenses of the Fund as older recipients move out of the system will eventually reduce that accumulated debt and DOL now estimates the accumulated debt will be retired in approximately 2014. This compares to a projected debt retirement date of 2007 under the Administration's proposal, a prospective variance of seven years which would cost the industry an estimated $350 million per year.

The President's FY 1988 budget, without regard to the competitive and trade importance of the industry, proposes to repeal that agreement by a) increasing the tax to $1.70/ton for underground coal and $.85/ton for surface mined coal[2], b) repealing the interest forgiveness agreement and requiring repayment of any interest already forgiven; and c) proposing modest benefit reform.

This is similar to the proposal made in 1985 -- a proposal which the Congress rejected as unrealistic and self-defeating in today's energy environment. Intense interfuel and international competition leave no room for tax increases without negative consequences to domestic production. The coal industry seeks a stable policy with respect to excise taxes to meet this competition. We urge this subcommittee to reject this proposal, and to permit the carefully crafted agreement of last year to continue in place. To date, the agreement has worked as projected.

Mr. Chairman, as a result of a drafting error, the black lung tax is scheduled to revert to its pre-1981 level in 1996. The 1986 agreement was intended to continue the higher tax level until the debt is extinguished. The coal industry is currently working with parties involved in the 1986 agreement to correct that problem. The industry recognizes its obligation to see that the Trust Fund achieves solvency. We believe that is consistent with the 1986 agreement.

In summary, Mr. Chairman, the nation's coal mines are cleaner and safer than in the days that lead up to the establishment of the black lung program. The goal of Congress was to set the program on a sound and equitable financial basis and this was accomplished in the 1986 compromise. An excise tax increase on coal production and consumption will not contribute to that goal.

[1] The fund is responsible for over 90,000 claimants and dependents eligible for monthly cash benefits. Since 1971 coal operators have assumed direct responsibility for claims where they have been identified as the responsible operator under the Black Lung Program.

[2] With a sales price cap of 6.8 percent.

Job # 4368 (Same as #2479 - 1/14)
CoBRANKP
TAX = $1.10/0.55
1986 - 2010

TABLE 10: ACCOUNTING SUMMARY FOR ENTIRE SIMULATION

[illegible]	BEGINBAL	EXPWOI	YEARREV	NETWOI	ENDWOI	AVGBWOI	INTPAID	INTRECVD	EXPWI	ADVANCES	CUMBAL
1979	-18.9	-615.7	222.7	-393.1	-412.0	-215.5	-7.74	0.0	-623.5	-450.4	-419.7
1980	-419.7	-760.2	277.0	-483.2	-902.9	-661.3	-52.50	0.0	-812.7	-535.7	-955.4
1981	-955.4	-698.7	253.2	-445.5	-1400.9	-1178.2	-109.49	0.0	-809.2	-555.0	-1510.4
1982	-1510.4	-622.6	500.2	-122.4	-1632.8	-1571.6	-160.60	0.0	-783.2	-283.0	-1793.4
1983	-1793.4	-666.6	502.2	-164.4	-1957.9	-1875.6	-193.27	0.0	-859.9	-357.7	-2151.1
1984	-2151.1	-637.9	526.2	-111.6	-2262.7	-2206.9	-234.50	0.0	-872.3	-346.1	-2497.2
1985	-2497.2	-630.6	569.8	-60.8	-2558.0	-2527.6	-274.75	0.0	-905.4	-335.5	-2832.7
1986	-2832.7	-628.8	577.5	-51.3	-2884.0	-2858.4	0.0	0.0	-628.8	-51.3	-2884.0
1987	-2884.0	-656.2	618.0	-38.2	-2922.2	-2903.1	0.0	0.0	-656.2	-38.2	-2922.2
		...STOP BORROWING...									
1988	-2922.2	-664.7	669.0	4.3	-2918.0	-2920.1	0.0	0.0	-664.7	4.3	-2918.0
1989	-2918.0	-672.1	676.3	4.2	-2913.8	-2915.9	0.0	0.0	-672.1	4.2	-2913.8
1990	-2913.8	-657.4	699.9	42.4	-2871.3	-2892.6	0.0	0.0	-657.4	42.4	-2871.3
		...START BORROWING...									
1991	-2871.3	-661.3	724.6	63.2	-2808.1	-2839.7	-307.44	0.0	-968.8	-244.2	-3115.6
1992	-3115.5	-663.6	745.6	82.0	-3033.5	-3074.5	-319.90	0.0	-983.5	-237.9	-3353.4
1993	-3353.4	-653.2	767.7	114.5	-3239.0	-3296.2	-330.94	0.0	-984.1	-218.4	-3569.8
1994	-3569.8	-648.0	785.9	137.9	-3431.9	-3500.9	-340.30	0.0	-988.7	-202.9	-3772.7
1995	-3772.7	-640.5	803.4	162.9	-3609.8	-3691.3	-350.13	0.0	-990.6	-187.2	-3959.6
1996	-3959.6	-630.0	812.2	182.2	-3777.5	-3868.9	-359.74	0.0	-988.6	-176.5	-4136.5
1997	-4136.5	-617.7	834.4	216.7	-3919.8	-4025.2	-366.80	0.0	-984.6	-150.1	-4286.7
1998	-4286.7	-602.6	857.3	254.7	-4032.0	-4159.3	-373.77	0.0	-976.3	-116.1	-4405.8
1999	-4405.8	-585.3	880.7	295.4	-4110.4	-4258.1	-379.25	0.0	-964.6	-83.9	-4489.6
2000	-4489.6	-566.0	904.6	338.6	-4151.0	-4320.3	-383.11	0.0	-949.1	-44.5	-4534.1
2001	-4534.1	-545.6	929.1	383.5	-4150.6	-4342.4	-385.15	0.0	-930.8	-1.7	-4535.6
		...STOP BORROWING...									
2002	-4535.6	-530.8	954.4	423.6	-4112.0	-4323.9	-385.23	0.0	-915.8	38.5	-4497.2
2003	-4497.2	-509.9	980.2	470.3	-4026.9	-4262.0	-381.95	0.0	-891.8	68.4	-4408.8
2004	-4408.8	-492.5	1006.8	514.3	-3894.5	-4151.7	-374.65	0.0	-866.9	139.9	-4268.9
2005	-4268.9	-474.4	1034.0	559.6	-3709.3	-3959.1	-362.57	0.0	-837.0	197.1	-4071.9
2006	-4071.9	-455.5	1062.0	606.5	-3465.4	-3769.5	-345.83	0.0	-801.3	260.6	-3811.2
2007	-3811.2	-436.3	1090.6	654.3	-3156.9	-3484.1	-323.69	0.0	-759.9	330.6	-3480.6
2008	-3480.6	-416.6	1120.0	703.1	-2777.5	-3129.0	-295.61	0.0	-712.5	407.5	-3073.1
2009	-3073.1	-397.5	1150.2	752.7	-2320.3	-2696.7	-261.00	0.0	-655.5	491.7	-2581.3
2010	-2581.3	-378.4	1181.1	802.7	-1778.6	-2160.0	-219.24	0.0	-597.6	523.5	-1997.3

BEGINBAL = BEGINNING OF YEAR FUND BALANCE
EXPWOI = YEAR'S COST OF BENEFITS WITHOUT INTEREST
YEARREV = YEAR'S REVENUE
NETWOI = YEAR'S NET BALANCE WITHOUT INTEREST
ENDWOI = END OF YEAR FUND BALANCE WITHOUT INTEREST
AVGBWOI = YEARLY AVERAGE FUND BALANCE
INTPAID = INTEREST PAID ON ADVANCES
INTRECVD = INTEREST EARNINGS FROM TRUST FUND SAVINGS
EXPWI = YEARLY COST WITH INTEREST
ADVANCES = ADVANCES, REPRESENTING LOANS WHEN NEGATIVE, OR REPAYMENT OR SAVINGS WHEN POSITIVE

ATTACHMENT

Senator Baucus. Florence, you state very strongly that if new-hires are mandatorially covered, it would have a very abrupt impact, and would be very expensive.

As you know, last year the Finance Committee adopted a provision with a transition period of five years in the event the pre-April 1, 1986 hires were covered. If we move in that direction, what kind of transition makes most sense?

Ms. Shapiro. Actually, what has taken place as far as the cities are concerned is we are already committed to that transition. We realize that as of April 1, 1986, that there will be that phase-in, and we have already begun. We do feel that within the next five to seven years, with that phase-in program, most of the people in our employment will be under Medicare, and we were willing to commit to that.

I think that what we are asking is that there not be such an abrupt beginning. On January 1, 1988, is what they are looking at to bring all hires under, and we are already in some programs now; it would be very difficult for us. It would be an abrupt beginning for us.

Senator Baucus. You say you are already doing it. Are you referring to Texas?

Ms. Shapiro. Yes.

Senator Baucus. Is that all Texas schoolteachers, or is that all state and local employees.

Ms. Shapiro. This is city municipal employees.

Senator Baucus. All right. Now what would the National League's position be?

Ms. Shapiro. Everybody is under this, all employees. All municipal employees are under the phase-in Medicare program, as of all new hires, April 1986.

Senator Baucus. Is this in Texas or in other states, too?

Ms. Shapiro. Nationally.

Senator Baucus. Nationally, for states that don't have these voluntary agreements?

Ms. Shapiro. Yes.

Senator Baucus. So you are saying then, even though you don't like it, if it is a five to seven year phase-in, that you are not strenuously objecting?

Ms. Shapiro. Exactly. Exactly.

Senator Baucus. Will you tell me a little bit, too, about gasoline taxes here? How much is involved in say an average city in the United States if cities and states are required to pay federal highway taxes?

Ms. Shapiro. My city is 120,000 people. I would say that is a good average-size city; it is not a small town. We are talking about last year having paid $55,000. A city comparable as the City of Fort Worth, Texas, has a population of about 450,000. They would be paying approximately a quarter of a million in gasoline tax.

Our main objective, quite frankly, although those seem like small dollars—our main objective is that it is an erosion of what we consider to be a reciprocal immunity agreement, which says that states and cities will not tax the federal government and vice versa—the federal government will not be taxing us.

What happens is, we have to raise our taxes in our community in order to be able to pay that federal tax. And once you begin and open that Pandora's box, we really feel that that will happen more and more, and that is a great fear. It is more than the $55,000 in the tax; it is really the fear that you are opening a Pandora's box for the future.

Senator **Baucus**. What is the precedent here? Are you aware of other taxes, other than payroll taxes, federal taxes, that cities currently have to pay?

Ms. **Shapiro**. I don't believe there are any, sir.

Senator **Baucus**. Do cities and towns pay any federal gasoline tax now at all?

Ms. **Shapiro**. No, they do not. We are exempt from federal gasoline tax today.

Senator **Baucus**. Thank you.

Chris, a question comes to my mind. You say that the Administration's proposal will make the Fund solvent by 2007, and under current law it would be solvent by 2014, roughly. Can we afford to wait until 2014? That is a long way off.

Mr. **Farrand**. Well, it is a long way off, Mr. Chairman. But this is a discrete trust fund, if you will. You could treat it as a microcosm of the federal debt. I mean, when are we going to extinguish the federal debt? We are going to get there; we are on a course to get there.

Senator **Baucus**. You can show us how. [Laughter.]

Mr. **Farrand**. I can show you how; it is better to be in your seat instead of this one.

But as long as it is on a footing that gets us there, I am not certain we are in danger. On an annual basis we are certainly not contributing to the deficit, the annual federal deficit. I think that is fairly clear. We are going to pay those costs.

We would argue, in some respect, that part of the reason the Trust Fund is in debt now is that there was a period in the late seventies when the eligibility rules were so lax that the number of beneficiaries ballooned much faster than anyone anticipated and much faster than the Fund was prepared for or that the tax level was prepared for, and we are now trying to clean up for that laxity.

Senator **Baucus**. What is your answer to the old problem we have in the West; that is, although the tax is levied on Eastern and Western coal, Western open-pit mining does not cause Black Lung? Why should Western coal operators have to pay a tax?

Mr. **Farrand**. As a Montana coal producer, I guess I can respond to that. In reality, Senator, if you are going to have a Black Lung Program and you put all of the burden of that program on underground mined coal, it would almost be self-defeating; you would end up with very little underground coal being mined and almost entirely surface-mining coal. That is an overstatement, but that is part of the problem.

Congress felt it had to put some of the burden on all of coal, but at a differential rate. If I asked my Montana mine superintendent about that, he can hardly speak, because he thinks it is a travesty. But you can't do it otherwise.

Senator BAUCUS. But speaking figuratively, for the overburdened Western coal industry the tax is pretty heavy. It is not only that, but its regulations under the Clean Air Act and all the other federal laws.

Mr. FARRAND. On the other hand, your basic mining costs in the West are by and large much less than they are either for Eastern surface or Eastern underground coal.

Senator BAUCUS. Thank you.

You mentioned the problems this additional tax would create on the American coal mining industry's international competitiveness. Could you flesh that out for us very briefly, please? What do you mean by that?

Mr. FARRAND. Well, until last year the U.S. was the largest exporter of coal in the world. We got eclipsed by the Australians for the first time last year. But we cannot pass that tax on in the international market; or, if we attempt to, we become less competitive, and we already have a serious problem there.

In the domestic market it becomes a more serious problem, and let me give you an example: Our Montana mine produces coal for a Minnesota utility. That utility is under intense competition from Canadian power imports. And to the extent that the cost of producing power from Montana coal is raised, then in the normal economic dispatch of that utility and the customers within this service area, some of those customers may go to Canadian power. Some of them may go to power from other fuel sources.

Senator BAUCUS. How did Australia pass us, the largest exporter of coal? Why? What happened there?

Mr. FARRAND. They captured the Pacific Rim market, by and large. Our exports to Japan, which is our largest export market for years, have diminished; they are no longer our largest single customer. They have lower labor rates. They have no reclamation law to speak of. There are a whole lot of factors that contributed to that.

We are a highly regulated industry in this country, and we have very stringent safety laws. We have, as you indicated, very restrictive environmental laws. And the only way we compete is to be very, very productive. We have very good productivity in this country.

We also have all these ancillary taxes like reclamation taxes and Black Lung taxes, and it is just a tough world out there. Every time you add a burden like this, a $350–$400 million annual burden, it just reduces or at least measurably reduces our competitiveness.

Senator BAUCUS. Thank you both very much; we appreciate your testimony.

The next panel will be William Dempsey for the Association of American Railroads; Mr. R.T. Bates, Chairman of the Railroad Retirement Committee and Chairman of the Brotherhood of Railroad Signalmen; and Mr. Michael Grisanti, Vice President and Chief Executive Officer of the National Restaurant Association, from Louisville, Kentucky.

All right, Mr. Dempsey, why don't you begin?

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT OF THE ASSOCIATION OF AMERICAN RAILROADS, ACCOMPANIED BY CHARLES I. HOPKINS, JR., CHAIRMAN, NATIONAL RAILWAY LABOR CONFERENCE

Mr. DEMPSEY. Thank you, Mr. Chairman.

With me is Mr. Charles Hopkins, who is the Chairman of the National Railway Labor Conference, which is the collective bargaining arm of the industry. These issues that we have been asked to discuss, while they are statutory issues, are also traditionally the subject of collective bargaining.

We have been asked to talk about three subjects. The first is the status of the Railroad Retirement Fund and the proposal of the Administration in its budget to increase so-called Tier II taxes. Those are the taxes that go to pay the benefits that are on top of the Social Security equipment benefits that we have in the industry—to increase those benefits by one and a half percent next January 1, and then another one and a half percent the January 1 after that. That is about $150 million a year, for a cumulative total of about $300 million a year.

We share the Administration's concern about the status of the account. What has happened in the industry has been a precipitous decline in employment—some 40 percent since 1980—so that we have the Social Security problem of a disproportionate ratio between retirees and active employees, and we have it in spades.

What we say, though, is that the problem is enormously complicated and enormously important to the industry and its employees, and therefore that it would be premature for the Congress to take action at this time. There is no short-term problem; the Fund, as a matter of fact, is growing at the present time. So we are looking at a medium- and long-range problem, and what we have traditionally done in the industry, in 1974 when the whole system was revamped and then again in 1981 and in 1983, what we have done is to bargain, unions and employers, and we have found ways to share the burden in an equitable way—not only by increased taxes on both employees and employers but also by way of benefit modifications.

We have begun those discussions with the unions. As I say, the problems are complex, and we simply feel that, since there is no emergency at all, we need more time to deal with that problem.

I think by way of underscoring the difficulty that we face, one need only look at the taxes that we are paying now. The employers are paying 26.2 percent of Tier II taxable compensation, the employees some 13.8 percent, for a total in taxes of 40 percent of Tier II taxable compensation, or 31 percent of total payroll. That is really an astronomical amount, and we need to find some way to cushion whatever shock there is. And we need some time to look at the new projections of the Chief Actuary of the Railroad Retirement Board.

The second issue that we have is the proposal of the Administration that the rail industry pick up some 25 percent of the costs of the so-called windfall dual benefits. Now, these windfall dual benefits arose before 1974 when the system was revised, because the Congress failed to integrate the Social Security System with the Railroad Retirement System; so that a person who worked for 15 years in the rail industry vested in the Railroad Retirement benefit, then went out to General Motors, worked for another 15 years, would in effect have two Social Security stocks. So he would get one Social Security benefit for his rail employment, one for his General Motors retirement, and the two together, since Social Security is weighted in favor of short-term employment, the two together would amount to more than an employee who worked for 30 years in any other industries would collect. That was inequitable. As the Congress recognized in 1974, that was not the rail's fault because we opposed it, but rather, in effect, the fault of the Congress.

Those benefits were terminated at that point except for employees who had already vested under both systems, and in 1974, and in 1981, and in 1983, the Congress declared that that was the full obligation of the Federal Government. This matter should have been laid to rest by this time; we trust that it will be this year.

If I may note, an identical proposal was made last year by the Administration, but not adopted by the Congress.

Finally, we have the question of whether or not the Federal Unemployment Compensation System should be eliminated and rail employees put under the state systems. This proposal has been made repeatedly by the Administration, in 1985, 1986, 1987, and rejected by the Congress. We have a problem with the federal system, but the taxes that were imposed last year together with the taxes that were imposed in 1983 increased by about 250 percent the employer taxes under this system, and that, together with benefit modifications that we have agreed upon with labor and that have been proposed to the Congress, ought to put this system on a sound financial basis, and we strongly urge that it be kept where it is; that is, under the federal aegis.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Dempsey.

Mr. Bates?

[Mr. Dempsey's written prepared testimony follows:]

March 23, 1987

Before the
TAXATION AND DEBT MANAGEMENT SUBCOMMITTEE
COMMITTEE ON FINANCE
UNITED STATES SENATE

JOINT STATEMENT ON PROPOSALS IN THE ADMINISTRATION'S FISCAL YEAR 1988 BUDGET RELATING TO THE RAILROAD RETIREMENT AND RAILROAD UNEMPLOYMENT INSURANCE SYSTEMS

by

WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

and

CHARLES I. HOPKINS, JR., CHAIRMAN, NATIONAL RAILWAY LABOR CONFERENCE

The Association of American Railroads represents almost all of the nation's major railroads in a wide variety of matters, including legislative questions that concern the railroad industry. The National Railway Labor Conference represents almost all of the nation's class I railroads in national collective bargaining and in regard to other matters concerning labor-management relations in the railroad industry, including revisions of the railroad retirement and railroad unemployment insurance systems. Hence, we are the principal officers of the two railroad associations that are directly concerned with legislation affecting those railroad systems. We are making this statement on behalf of those associations and their member railroads.

We understand that we should direct our comments to the proposals in the Administration's Fiscal Year 1988 Budget (1) to increase tier II railroad retirement taxes because of concerns about the medium- or long-range outlook for the financial solvency of the Railroad Retirement Account (which funds tier II benefits), (2) to finance out of that Account (and thus out of tier II taxes) 25% of the costs of so-called "windfall" dual benefits, and (3) to terminate the railroad unemployment insurance system and bring the railroad industry within the coverage of the Federal/State unemployment compensation system applicable to other industries.

We share the concern about long-range financial solvency of tier II of the railroad retirement system, but we urge that action by the Committee at this time upon the proposed tax increase would be premature. First, no one suggests that there is or will be an immediate financial crisis over at least the next five years. Second, labor and management should be given an adequate opportunity to discuss this complex matter as they have in the past. Tier II generally is the equivalent in the railroad industry of collectively-bargained private pension plans in other industries; railroad labor and management traditionally have bargained and agreed upon joint recommendations for revisions that, among other things, fairly share the burden of resolving threats to the future solvency of tier II that are apparent at the time; and the Congress heretofore has given great weight to those recommendations. Railroad labor and management already have initiated discussions in regard to such joint recommendations, but the problem is a difficult one and more time is needed before we can agree upon a program to recommend to the Congress. We suggest, therefore, that the parties be given a reasonable time in which to negotiate upon such joint recommendations.

The railroads oppose outright the proposed change in the method of financing windfall dual benefits. The solution to the "windfall" problem adopted by the Congress when it enacted the Railroad Retirement Act of 1974, including the financing out of the general fund of the costs of phasing out such benefits, essentially was reconfirmed by the Congress in 1981 and 1983. That issue should be regarded as settled. The Congress did not adopt this proposal as made in the Administration's FY 1987 Budget and it should not do so now.

We also oppose outright the proposal to bring the railroad industry within the coverage of the Federal/State unemployment compensation system. That proposal is simply a renewal of a proposal made in the FY 1985, FY 1986 and FY 1987 Budgets. The Congress not only failed to adopt that proposal as thus previously made, but has enacted legislation inconsistent with the Administration's approach and which undercuts the asserted justification for that proposal. Legislation drafted by the Administration to implement its prior proposals would have imposed enormous additional costs on the railroads, including payment for several years of full taxes or contributions now imposed under the railroad system plus those imposed under the Federal/State system. Rather than jettison the railroad unemployment compensation system, which has been in existence for almost 50 years, the Congress should enact legislation -- supported by both railroad labor and railroad management -- that would further improve that system in accordance with recommendations by the Railroad Unemployment Compensation Committee.

We explain below in more detail our position with regard to each of those proposals.

The Proposed Increase in Tier II Taxes

Tier I of the railroad retirement system essentially is equivalent to social security in other industries, including tier I taxes imposed by the Railroad Retirement Tax Act (Chapter 22 of the I.R.C.) identical to social security taxes. Both the railroads and their employees now pay tier I taxes at the rate of 7.15% of taxable compensation. That rate -- like the social security rate -- is scheduled to increase to 7.51% in 1988 and to 7.65% in 1990. 26 U.S.C. §§ 3201(a) and 3221(a).

Tier II of the Railroad Retirement Act of 1974 provides old-age and disability benefits to retired or disabled railroad employees, their spouses and survivors over and above the tier I or social-security equivalent benefits. See 45 U.S.C. §§ 231 *et seq*. It thus is analogous to collectively-bargained private pension plans in other industries. Those benefits primarily are financed out of tier II taxes imposed under the Railroad Retirement Tax Act at the rate of 14.75% of taxable compensation in regard to employers and 4.25% of taxable compensation in regard to employees. 26 U.S.C. §§ 3201(b) and 3221(b). In addition, the railroads alone pay a supplemental tax fixed quarterly by the Railroad Retirement Board at an amount "for each man-hour for which compensation is paid" sufficient to fund the cost of certain supplemental tier II benefits paid to retired long-term employees. 26 U.S.C. § 3221(c). That amount is now fixed at 24 cents per man-hour.

In 1987, taxable compensation is subject to a $43,800 maximum for the tier I tax and to a $32,700 maximum for the tier II tax. The combined tier I and tier II taxes payable in 1987 by the railroads amount to 24.4% of taxable compensation under tier II and the supplemental tax amounts to another 1.8%, for an overall percentage of 26.2% of tier II taxable compensation. The combined tier I and tier II taxes payable by railroad employees in 1987 amounts to 13.8% of tier II taxable compensation. The total for the railroad industry in 1987 thus comes to 40% of tier II taxable compensation, which is equivalent to 31% of total payroll. Those figures speak for themselves. They make it obvious that railroad retirement taxes have reached the extreme upper limits of what is reasonably bearable. Any proposal for a further increase calls for thorough and careful consideration before the Congress acts.

Nonetheless, the Administration proposes to increase tier II railroad retirement tax rates by 1.5% effective January 1, 1988 and by an additional 1.5% effective January 1, 1989. This is said to be necessary to "protect the solvency of the fund," as "[f]inancing legislation for the rail industry pension fund enacted in 1974, 1981, and 1983 was based on what has proven to be optimistic assumptions, and Railroad Retirement Board actuaries now recommend measures equivalent to raising rail pension contributions" by those amounts. FY 1988 Budget at 2-40.

The Administration in its Budget did not indicate how the proposed tax increases should be allocated, but has since urged that they should "be shared by the employer and the employee." February 4, 1987 Statement to the Senate Finance Committee by Assistant Secretary of the Treasury for Tax Policy J. Roger Mentz at page 12. In oral testimony, Mr. Mentz further stated that the sharing should be on a fifty-fifty basis as between employers and employees. Moreover, as stated in the above paragraph that tax proposal is based on "recommendations by Railroad Retirement Board actuaries . . . ." We understand that statement to refer to a report from the Board's Chief Actuary setting forth his technical views and recommendations to the Board, enclosed with the Board's June 27, 1986 Report to the Congress pursuant to § 502 of the Railroad Retirement Solvency Act of 1983 (P.L. 98-76). Among other things, the Chief Actuary states in his report (at p. 5) that:

> "This report contains no recommendations regarding the relative proportion of the burden of additional financing which should be borne by railroad employers, employees and beneficiaries. The recommendation which follows [for two 1.5% increases] is stated in terms of tax increases, but this is not meant to exclude the possibililty of reducing any necessary tax increase by adjusting benefits. Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of any tax increase to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits."

The suggestion by the Chief Actuary that the "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations" accords with the past practice of the Congress as well as with common sense. Among other things, the major restructuring of the railroad retirement system enacted by the Railroad Retirement Act of 1974 (which replaced the Railroad Retirement Act of 1937) was based in large measure upon joint recommendations of a labor-management negotiating committee, established pursuant to specific directions of the Congress to make such recommendations (see 86 Stat. 767, 87 Stat. 165) in the light of a report of a Commission on Railroad Retirement previously established by the Congress (84 Stat. 792-

794). That Commission included representatives of railroad labor and management and was directed to make a study of the system and recommend changes to provide an adequate level of benefits on an actuarially sound basis. So, too, the less far-reaching revisions in 1981 and 1983 to which the Administration refers were based in large measure upon joint recommendations by railroad labor and management agreed upon in more informal negotiations.

It essentially is true that, as the Administration has stated in its Budget, the legislation "enacted in 1974, 1981, and 1983 was based on what has proven to be optimistic assumptions," although that "proof" involves further actuarial predictions of future occurrences which necessarily cannot be hard and fast. This is not because the actuarial assumptions made at the time intentionally were optimistic or misleading. Rather, the recommendations made by railroad labor and management in 1974, 1981 and 1983, and the legislation enacted by the Congress, were based upon the best actuarial advice available, including that of the Chief Actuary of the Railroad Retirement Board, in the light of what were then thought to be prudently pessimistic assumptions. Indeed, as recently as the 1985 § 502 report, the Chief Actuary -- while not foreclosing questions as to the long-term stability of the railroad retirement system -- did not see any need to recommend an adjustment in tier II tax rates as "even substantial declines in employment will not bring about cash-flow problems" in the "next 10 to 20 years," and concluded that it was "feasible to divert a portion of [tier II] taxes to the Railroad Unemployment Insurance Account to aid in the repayment of its debts to the Railroad Retirement Account." See Sixteenth Actuarial Valuation, Part C, at 2-3.

We do not intend to criticize or blame the Board's Chief Actuary or prior occupants of that position. In our opinion, they have performed a difficult and demanding role as well as reasonably could be expected. The problem is not in the Actuary but in the nature of actuarial predictions. They necessarily involve assumptions as to future occurrences about which no one can be certain in advance of the fact. In particular, actuarial predictions regarding the future financial status of the Railroad Retirement Account are strongly influenced by assumptions regarding future railroad employment. Apart from short-term fluctuations, railroad employment has been declining for many years. For example, in 1937 when the Railroad Retirement Act of 1937 was enacted, railroad employment averaged 1,279,000; in 1974 it averaged 592,000; in 1981 it averaged 503,000; in 1983 it averaged 395,000; and in 1986 it averaged 338,000. While further declines seem inevitable, it also seems inevitable that the recent rate of decline in employment must eventually abate if the railroad industry is to continue to exist. The difficult problems are to predict when that will occur and what declines will occur in the interim. The reversal between the 1985 report and the 1986 report in the recommendations made by the Chief Actuary primarily is attributable to changes in his future employment assumptions.

As the Chief Actuary noted in his 1986 § 502 report, for purposes of his 1985 report, his A (least pessimistic), B (intermediate) and C (most pessimistic) valuations assumed that "employment would decline from its 1984 level by two percent, three percent and four percent annually, respectively, through 2000," which "rate of decline was assumed to decrease in later years." Thus, the assumed employment levels in 2010 were 255,000 under

Valuation A, 205,000 under Valuation B, and 163,000 under Valuation C. See Report at 1. Given those assumptions, under Valuation A, "an actuarial surplus existed and no cash-flow problems arose throughout the projection period," and under Valuations B and C cash-flow problems would not arise until 2014 or 2005, respectively. See Report at 5. However, in view of the sharp decline in employment in 1985, when no economic recession was in progress to account for the decline, the Chief Actuary in the 1986 § 502 report assumed future annual declines at the rate of 3.5%, 4.0% and 4.5% for Valuations A, B and C, respectively. This plus a lower starting base resulted in assumed employment levels in 2010 of 146,000 as to Valuation A, 129,000 as to Valuation B, and 114,000 as to Valuation C. See Report at 2-3 and 7. Those assumed levels are 43%, 37% and 30% lower, respectively, than the employment levels for 2010 assumed in the 1985 report. These revised employment assumptions further resulted in actuarial predictions that the Railroad Retirement Account will run out of funds in 2007 under Valuation A, in 2005 under Valuation B, and in 2003 under Valuation C. See Report at 4, 8-10.

We are not prepared to say at this time that those revised employment assumptions are unjustified. While it obviously is true, as stated by the Chief Actuary on page 5 of his 1986 § 502 report, that "[n]o one can be certain that these declines will materialize," significant further declines in employment during at least the next few years appear to us to be probable although continuation for more than a decade of the same rate of decline is much more debatable. If the railroads are to compete successfully in today's competitive environment, they must significantly increase productivity by all available means, including elimination of unneeded manpower. If that is not done, extensive truck and barge competition, and the lack of growth by major rail shippers, may lead to even larger reductions in employment.

However, as the Chief Actuary recognized in his 1986 report (at p. 5), "the railroad retirement system's fund is expected to continue growing for several years without new legislation, even under the most pessimistic employment assumption," and there "is no immediate danger of having to curtail benefits in the absence of additional financing." Thus, there is ample time to follow his suggestion, which we strongly endorse, that the "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of any tax increase to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits."

Neither the Chief Actuary nor the Administration has recommended how that allocation should be made although -- as noted above -- the Administration has urged that its proposed tax increases be shared equally between employers and employees. A fair allocation of the burden between tax increases for employers, tax increases for employees, and benefit adjustments (all of which occurred, for example, in 1983) obviously is a most difficult problem involving conflicting interests that require careful consideration. Certainly, consideration should be given to adjustments in the benefits payable to future retirees as well as to the tier II taxes paid by the railroads and by their employees. Moreover, one result of prior actuarial assumptions that have "proven to be optimistic" is that benefits for retirees on the rolls were set at levels that may now be thought to be unjustifiably high in view of subsequent experience. In addition, a significant portion of the long-term financial problems of the Railroad Retirement Account were caused by the federal government. Although the Congress in enacting the Railroad Retirement Act of 1974 concluded that it primarily had been at fault in providing so-called "windfall" dual benefits, over the opposition of the railroads and initially of the unions, and remedied that problem for the future, the payment of such benefits already had cost the Railroad Retirement Account in excess of $4 billion dollars. See p. 13 infra. That loss, which continues to grow because of lost interest, never has been made up to the Account. There also have been other occasions in which benefits have been imposed or increased in response to political pressures, rather than to labor-management agreement.

In view of all these complex considerations, it may even be desirable to have another thoroughgoing restructuring of the railroad retirement system based upon an in-depth study such as the study by the Commission on Railroad Retirement that preceded the enactment of the Railroad Retirement Act of 1974. At present, however, we urge only that railroad labor and management be given more time to come up with joint recommendations as to the financing of tier II railroad retirement benefits. While some informal initial discussions have been had, efforts to complete the current round of national wage and rules negotiations have been all-absorbing. Much more intensive discussions of railroad retirement are needed.

The Proposal for Partial Rail-Sector Financing of the Costs of "Windfall" Benefits

The Administration has proposed "having the rail sector finance 25 percent of Federal windfall subsidy costs." FY 1988 Budget Supplement at

5-119. It proposes that this be done through a rider to the appropriations to the Dual Benefits Payments Account under which $276 million would be appropriated to that Account out of the general fund and an additional $92 million "shall be derived from the rail pension fund"; i.e., from the Railroad Retirement Account that is funded from the tier II taxes paid by the railroads and their employees. See FY 1988 Budget Appendix at I-Z 81 and 82. That proposal is said to be based upon a finding by the General Accounting Office "that rail industry funded pensions are reduced by some 25 percent of windfall amounts," and a suggestion by GAO "that it may be more accurate to subsidize only 75 percent of total windfall costs." FY 1988 Budget Supplement at 4-20.

The same proposal with the same justification was included by the Administration in its Fiscal Year 1987 Budget (at 4-10). It was not adopted by the Congress last year and it should not be adopted now.

In essence, a "windfall" dual benefit amount is the amount by which the total of the tier I railroad retirement and social security benefits payable to an individual, who qualified under both systems, exceeds the total amount that social security would pay if that system also covered railroad employment. This excess amount resulted from the fact that, prior to the Railroad Retirement Act of 1974, the Congress had not coordinated the computation of the two benefits. Application of the social security benefit formulas separately to railroad and non-railroad employment produced a greater combined amount than would application of those formulas to combined employment. The entire cost of those excess benefits was borne by the railroad retirement system even though they were attributable to the social security benefit formulas and non-railroad employment. While the 1974 Act eliminated that problem for the future, the Congress concluded that individuals who had established a vested right to a windfall amount should continue to be paid that amount. See H. Rept. No. 93-1345 (1974) and S. Rept. No. 93-1163 (1974) at 1-13.

The Congress also determined in 1974 that the full amount of the costs of thus phasing out windfall dual benefits should be paid through appropriations from the general fund. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 2-11. Among other things, the "railroads had no part in the creation of the current situation" and the windfall benefit arose "out of non-railroad employment . . . which has not benefitted the railroad industry in any fashion," so that "it would be unfair to the railroad industry to saddle the carriers with the cost of phasing out dual benefits." H. Rept. No. 93-1345 and S. Rept. No. 93-1136 at 4. That is particularly true since the payment of windfall benefits prior to enactment of the 1974 Act had cost the railroad retirement system "in excess of $4 billion," which was paid out of railroad retirement taxes and has never been reimbursed to the system. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 2-3. In thus providing for payment out of the general fund of the costs of phasing out windfall benefits, the Congress was aware that the tier II benefit formula provided for a partial offset of the windfall amount against the tier II benefit otherwise payable — as had been done under the Railroad Retirement Act of 1937. See H. Rept. No. 93-1345 and S. Rept. No. 93-1163 at 34.

On March 9, 1981, the Comptroller General transmitted to the Chairman of the House Committee on Government Operations a GAO Report — entitled "Keeping the Railroad Retirement Program on Track - Government and

Railroads Should Clarify Roles and Responsibilities" -- in which GAO noted that offset and suggested that it might justify a concomitant reduction in windfall appropriations (Report at 31-34). Nonetheless, later that year, in the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35), the Congress adopted amendments to the Railroad Retirement Act of 1974 that, among other things: (1) revised the tier II benefit formula, but in so doing retained and specifically provided for a reduction of the basic tier II amount "by 25 per centum of the amount computed" for the individual under the windfall provisions; (2) established a separate Dual Benefits Payments Account for the payment of windfall benefits; and (3) limited the total amount of such payments in a fiscal year to the amount appropriated by the Congress for that purpose. See 95 Stat. 630, 638-639; H. Rept. No. 97-208 (Conf. Rept. 1981) at 861, 866-867.

The establishment of a separate Dual Benefits Payments Account and the limitation of such payments to the amounts appropriated therefor, was attributable to the fact that -- while the Congress in the 1974 Act had authorized and intended that the costs of phasing out windfall benefits be paid from appropriations from the general fund -- the actual appropriations had fallen short of the necessary amount, which created an unintended drain upon the Railroad Retirement Account as funded by tier II taxes. The Congress in 1981 did not make up for the shortfall during the 1975-1981 period, but it did so with interest as a part of the amendments to the Railroad Retirement Act of 1974 adopted in the Railroad Retirement Solvency Act of 1983 (P.L. 97-76). See 97 Stat. 433-434; H. Rept. No. 98-30 (Pt. 1, 1983) at 20-21, 26, 29, 41.

In H. Rept. No. 98-30, supra at 20, it was noted, among other things, that the Congress in the 1974 Act intended "for the cost of dual benefits . . . to be reimbursed out of general revenues;" that the failure of OMB "to ask for sufficient funding" resulted in a shortfall that "was in effect, being financed through the Tier II tax, contrary to the clear intent of the 1974 Act;" that even after the 1981 Act "OMB continued to oppose full funding" which initially resulted in a cut in windfall benefit payments until such funding was restored by the Congress in appropriations from the general revenues; and that:

> "On March 1, 1983, in testimony before the Subcommittee on Commerce, Transportation and Tourism, OMB Director Stockman testified that he supported making the dual benefit a fully-funded entitlement. The Committee is pleased that the Administration has finally agreed with the Congress that earned benefits to retirees should not be cut."

Nevertheless, despite that history and the 1983 testimony by Director Stockman supporting full funding of the costs of phasing out windfall benefits through appropriations from general revenues, OMB and the Administration once again are proposing that a part of those costs be financed "through the tier II tax" which, as H. Rept. No. 98-30 stated, is "contrary to the clear intent of the 1974 Act." That intent of the Congress was reaffirmed in 1981 and in 1983. It in effect was reaffirmed last year when the Congress ignored a proposal in the FY 1987 Budget identical in all respects to the proposal in the FY 1988 Budget now being considered by this Subcommittee. That proposal would depart from a resolution of the windfall benefit problem that the Congress established in 1974 and has repeatedly reaffirmed. The proposal once again should be rejected.

The Proposal To Bring the Railroad Industry Within the Coverage of the Federal/State Unemployment Compensation System

The Railroad Unemployment Insurance Act was enacted in 1938 to provide an unemployment compensation system, effective July 1, 1939, for unemployed workers in the railroad industry. 45 U.S.C. §§ 351 et seq. Thus, that system (which since 1947 also has provided sickness benefits) has been in existence for almost 50 years. The Administration states that it "is renewing its proposal that Federal/State unemployment insurance coverage be extended to railroad employment" so as to "ensure sound financing of rail unemployment benefits and repayment of debts to the financially ailing rail pension fund . . . ." FY 1988 Budget Supplement at 4-19 and 20.

The same proposal was made by the Administration in its FY 1985 Budget (at 4-13), its FY 1986 Budget (at 4-10), and its FY 1987 Budget (at 4-7 and 8). Rather than adopt that approach, the Congress enacted legislation strengthening the financing of the RUI system and that is otherwise inconsistent with that approach. Moreover, bills reported to both Houses of the Congress in the last session would further improve the existing RUI system in accordance with recommendations of the Railroad Unemployment Compensation Committee established by the Congress for that purpose. While the session ended before either House acted on those bills, both railroad labor and railroad management support enactment of such legislation in this session of the Congress. Thus, the railroads strongly oppose the Administration's renewed proposal for coverage of the railroad industry by the Federal/State UC system. We note that the Administration's proposal was not even formally introduced in the last Congress.

A borrowing authority is an essential feature of a rational unemployment compensation system as it permits benefits and tax levels to be maintained on a relatively even keel despite temporary swings in the unemployment rate. Section 10(d) of the RUI Act thus authorizes the RUI Account to borrow from the Railroad Retirement Account when necessary to assure payment of full unemployment and sickness benefits, which borrowings are repayable with interest generally equivalent to that earned by the Railroad Retirement Account on its investments. 45 U.S.C. § 360(d). Under § 8 of the RUI Act, employer contributions in a calendar year may vary between 0.5% and 8% of taxable compensation, depending upon the balance in the RUI Account as of the preceding September 30. Contributions are fixed at the 8% maximum if that balance is less than $50 million which, of course, is true if all loans have not been fully repaid. 45 U.S.C. § 358.

This borrowing authority served its intended purpose without giving rise to any problems through the end of FY 1980. While borrowings often occurred, they always had been repaid with interest. No loans were outstanding at the end of either FY 1979 or FY 1980. However, the severe unemployment during the 1981-1983 recession, plus the high interest then payable on borrowings, among other factors, resulted in a debt that grew beyond the ability of the RUI system as then constituted to repay (e.g., $575 million as of the end of FY 1983). In the Railroad Retirement Solvency Act of 1983 (P.L. 98-76), the Congress, among other things, (1) increased taxable compensation (and thus employer contributions) by 50% from $400 to $600 per month, (2) repealed the RUI Account's borrowing authority effective September 30, 1985; (3) enacted a Railroad Unemployment Repayment Tax, effective from July 1, 1986 through September 30, 1990, the proceeds of which were to be applied to repayment of the pre-October 1, 1985 debt; and (4) established a Railroad Unemployment Compensation Committee to review all aspects of the RUI system and make recommendations to the Congress with respect, among other things, to repayment of that debt by the end of FY 2000. 97 Stat. 426-430, 432, 440-442.

The June 29, 1984 Report of the RUC Committee contained a "consensus package" of recommendations that, among other things, would increase the maximum on employer contributions to 12% of taxable compensation with the contribution rate determined by individual-employer experience rating subject to that maximum. Other recommendations included increasing the maximum daily benefit from $25 to $27; indexing of the maximum daily benefit and of the taxable compensation base; a tightening of certain eligibility requirements; a new borrowing authority; and surcharges on experience-rated contributions (ranging from 1.5% to 3.5%) in the year after a September 30 in which the balance in the RUI Account reached specified low levels so as to minimize the need for borrowing and to assure repayment with interest of any loans that did occur. In regard to the existing debt, the RUC Committee recommended that the principal be repaid through supplemental contributions (not subject to the 12% maximum) and that all interest accrued since 1980 be forgiven.

In the Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272), the Congress, among other things, (1) permanently restored the authority of the RUI Account to borrow from the Railroad Retirement Account (several temporary extensions previously had been enacted); (2) revised the Railroad Unemployment Repayment Tax with respect to repayment of the pre-

October 30, 1985 debt; and (3) enacted a 3.5% surcharge tax (applicable to a $7,000 annual taxable wage base) to be imposed in a calendar year after a September 30 in which all post-September 30, 1985 borrowings have not been repaid with interest. The revised Repayment Tax continues to be effective from July 1, 1986 through September 30, 1990, and its proceeds continue to be dedicated to repayment of the pre-October 1, 1985 debt. However, the rates of that tax were increased from 2% to 4.3% for the last six months of 1986, from 2.3% to 4.7% during 1987, and from 2.6% to 6% during 1988, with the 2.9% rate during 1989 and the 3.2% rate during the first nine months of 1990 being continued without revision. 100 Stat. 325-327.

The cumulative effect of the 50% increase in employer contributions plus the Repayment Tax has been to raise maximum employer contributions or taxes per full-time employee from $384 per year in 1983 to $905 per year in 1987 and $996 in 1988. If the 3.5% surcharge tax should become applicable, another $245 per year would be added on top of those amounts. While this near tripling of unemployment taxes has been a substantial burden on the railroads, as we shall point out in more detail it has assured the future solvency of the RUI system and has created substantial resources for reduction of the past debt to the Railroad Retirement Account.

While that legislation in effect preempted certain of the recommendations by the RUC Committee, in its June 29, 1984 report, other recommendations would have been effectuated by S. 1968 reported by the Senate Labor and Human Resources Committee on April 15, 1986 and by H.R. 5501 reported by the House Energy and Commerce Committee on September 30, 1986. See S. Rept. No. 99-281 and H. Rept. No. 99-931 (Pt. 1). H.R. 5501 as reported also reflected certain proposed changes jointly recommended by railroad labor and management in August 1986, including a lengthening to one week of the waiting period before any benefit is payable and an initial increase in the maximum daily benefit to $30 in view of the time that had elapsed since the RUC Committee's report. Although the Congress adjourned before acting upon either of those reported bills, railroad labor and management are hopeful that this session of the Congress will enact legislation comparable to H.R. 5501. Such legislation has been introduced as H.R. 1356.

The foregoing developments, including the legislative actions already taken by the Congress, plainly are inconsistent with the Administration's renewed proposal to bring the railroad industry within the coverage of the Federal/State UC system. They indicate that the Congress, as well as railroad labor and management, prefers to continue and improve the independent RUI system. Our position in that regard is not based upon opposition to the principle (with which we generally agree) that federal legislation should treat the railroad industry in the same manner as other industries, but upon the apparently insuperable difficulty of making a transition to coverage by the Federal/State system in a manner that would be fair and equitable to all concerned.

In addition to being technically deficient in many respects (see Appendix H to the Report of the RUC Committee), draft legislation transmitted by the Administration to the Congress for the purpose of effectuating similar proposals in the FY 1985, 1986 and 1987 Budgets would have placed the entire cost of the transition upon the railroads, including the payment of both full

RUI contributions and full Federal/State unemployment compensation taxes for an indefinite but substantial future period of several years duration. Among other things, the railroads would be required not only to retire the RUI system's debt to the Railroad Retirement Account, but also to pay Federal/State UC taxes utilized in part to repay past borrowings by the State systems from the general fund of the Treasury for which the railroads are not in any way responsible. See Chapter 5 of the Report of the RUC Committee. Upon the basis of a methodology agreed to by our experts with experts at the Department of Labor, we estimated in 1985 that during the 1986-2000 period the cost to the railroads of a transition to Federal/State coverage as proposed by the Administration would exceed the cost of continuing the RUI system as revised in accordance with the "consensus package" recommendations of the RUC Committee by some $1.6 billion. Nothing in the FY 1988 Budget indicates that the Administration envisages legislation significantly different from the drafts transmitted to the Congress pursuant to prior such Budget proposals, and we have been unable to draft legislation for a transition to Federal/State coverage that appears to have some chance of enactment without imposing large additional costs upon the railroads.

Moreover, as we have noted, the post-1982 legislation enacted by the Congress already has placed the RUI system on a sound financial basis insofar as future benefits are concerned. Revenues consistently have exceeded benefit and administrative costs, no post-September 30, 1985 borrowings have occurred, and Railroad Retirement Board actuaries predict that this will continue to be true through the end of FY 2000 and beyond. If borrowing should occur which cannot promptly be repaid from ordinary employer contributions, the 3.5%

surcharge tax will be imposed so as to assure prompt repayment with interest. Furthermore, enactment of H.R. 1356 or similar legislation as recommended by railroad labor and management will provide additional assurances in that regard. Not only would the maximum contribution rate be increased from 8% to 12%, but experience rating will gear the individual-employer rate to benefits chargeable to the employer, and surcharges of 1.5% or 2.5% will be added to such rates (subject to the 12% maximum) in the year following a June 30 on which the balance in the RUI Account drops below specified levels even though that balance is positive. Thus, prompt and full repayment of any future loans from the Railroad Retirement Account will be highly probable even apart from the 3.5% surcharge tax enacted by the 1985 Reconciliation Act.

The pre-October 1, 1985 debt to the Railroad Retirement Account (including accumulated interest) amounted to $865.9 million as of September 30, 1986. Railroad Retirement Board actuaries estimate that, assuming no further legislative changes, the debt will be reduced to $522.1 million by September 30, 1990, when the Repayment Tax expires, and to $378.1 million by September 30, 2000. They also estimate that the revenues from the Repayment Tax will total $467.8 million. The further reductions in that debt would result from repayments out of a surplus of regular RUI contributions (at the 8% maximum) over expenses that is anticipated throughout the 1986-2000 period.

While the pre-October 1, 1985 debt apparently would not be fully repaid by the end of FY 2000, in the absence of further legislation, the anticipated revenues from the Repayment Tax plus further repayments from a surplus of regular contributions should more than accomplish the recommendation by the RUC Committee that the principal of that debt ($525.6 million) be repaid. Any unrepaid amounts should not have a significant effect upon the deficit in the Railroad Retirement Account projected in the 1986 Section 502 report by the Chief Actuary of the Railroad Retirement Board. Both anticipated revenues and anticipated expenses of the Railroad Retirement Account substantially exceed $2 billion annually, and thus dwarf any potential loan repayments. In the first deficit year predicted by the Chief Actuary in the 1986 Section 502 report, the projected amount of the deficit substantially exceeds the $378.1 million unrepaid debt projected as of the end of FY 2000 ($781 million in 2007 under his Valuation A, $1.325 billion in 2005 under his Valuation B, or $1.004 billion in 2003 under his Valuation C). Hence, full repayment of the debt by the end of FY 2000 would not put off the projected initial year of a deficit in the Railroad Retirement Account, assuming that neither the railroad retirement statutes nor the RUI Act are further revised. In view of these circumstances, and the likelihood that both statutes will be revised well before the end of FY 2000, there is no reason at this time to increase or extend the Repayment Tax or otherwise to enact specific additional taxes directed towards repayment of the pre-October 1, 1985 debt.

Consequently, the Congress already has enacted legislation that undercuts the asserted basis for the Administration's renewal of its proposal to bring the railroad industry within the coverage of the Federal/State UC system; i.e., to "ensure sound financing of rail unemployment benefits and repayment of debts to the financially ailing rail pension fund . . . ."

Pending legislation supported by railroad labor and management would provide further assurance that the RUI system will be financially sound and, as previously discussed, we believe that there is more than adequate time for railroad labor and management to negotiate and agree upon joint recommendations that will rectify the long-term financial problems of the Railroad Retirement Account. In short, there is even more reason now than there was in respect to the similar proposal made in the FY 1985, 1986 and 1987 Budgets to regard the issue as settled and to proceed to the consideration of legislation -- such as H.R. 1356 -- that would improve rather than destroy the independent RUI system that has been in existence for almost 50 years.

Conclusion

We appreciate this opportunity to appear before the subcommittee and express the views of our respective associations and their member railroads in regard to the foregoing proposals in the FY 1988 Budget. We shall be pleased to respond to any questions that members of the subcommittee may have in regard to these matters.

STATEMENT OF R.T. BATES, CHAIRMAN, RAILROAD RETIREMENT COMMITTEE, AND PRESIDENT, BROTHERHOOD OF RAILROAD SIGNALMEN, FOR THE RAILWAY LABOR EXECUTIVES ASSOCIATION

Mr. BATES. My name is Tom Bates. I am Chairman of the Railroad Labor Executives Association Committee on Railroad Retirement. I am also President of the Brotherhood of Railroad Signalmen headquartered in Mount Prospect, Illinois.

As you no doubt know, the Railway Labor Executives Association is comprised of the presidents of the standard national and international railway labor organizations, which represent virtually all of the contract employees on Class I railroads in the United States.

The chief actuary of the Railroad Retirement Board recommended that the Tier II Railroad Retirement tax rate be increased by 1.5 percent on January 1, 1987, and 1.5 percent on January 1, 1988. The Administration's fiscal year 1988 budget seeks the 1.5 percent on January 1, 1988, and 1.5 percent on January 1, 1989. The budget also proposes that 25 percent of the vested dual benefits be paid from the Railroad Retirement Account.

Traditionally, changes in benefits and taxes for the Railroad Retirement System have been negotiated by the railway labor organizations and the management of the railroads. We believe that the burden of the increased taxes should be borne by the railroads because the current financial projections are based solely on the industry-wide policy of reduction in the work force and at the same time reducing the available tax base by reductions in entry-level pay.

The railroads make every effort to remove workers from coverage by the Railroad Retirement Tax Act by the employment of workers not directly employed by the railroads but performing railroad work as employees of contract forces. The employees have no control over such policies. Notwithstanding this position, we also believe that rail labor and management should be permitted to negotiate and make recommendations to the Congress for a means to continue the financial stability of the Railroad Retirement System.

The Administration's Office of Management and Budget proposes that 25 percent of the remaining costs of dual benefits be financed from the Railroad Retirement Account. In 1974, 1981 and 1983, Congress rightfully assumed that burden, and rail labor opposes using funds from the Railroad Retirement Account to finance the windfall dual benefit. OMB Director Stockman supported making the dual benefits a fully-funded entitlement in 1983.

As indicated in our statement, there is no immediate crisis in the funding of the Railroad Retirement System, and we urge your committee to permit rail management and labor an opportunity to negotiate and made recommendations for the resolution of this most important matter.

Thank you for your attention, and I will be happy to respond to any questions you may have.

Senator BAUCUS. You bet. Thank you, Mr. Bates.

Let us go to you, Mr. Grisanti.

[Mr. Bates' written prepared statement follows:]

Before the
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

STATEMENT OF R. T. BATES, CHAIRMAN, RAILROAD RETIREMENT COMMITTEE, RAILWAY LABOR EXECUTIVES' ASSOCIATION; AND, PRESIDENT, BROTHERHOOD OF RAILROAD SIGNALMEN

ON PROPOSALS IN THE FISCAL YEAR 1988 BUDGET RELATING TO THE RAILROAD RETIREMENT SYSTEM

MARCH 23, 1987

My name is R. T. Bates. I am Chairman of the Railroad Retirement Committee of the Railway Labor Executives' Association and President of the Brothrhood of Railroad Signalmen. My office is at 601 W. Golf Road, Mt. Prospect, Illinois 60056.

The Railway Labor Executives' Association is an unincorporated association, the members of which are the chief executive officers of all of the standard national and international railway labor organizations representing virtually all of the contract employees of all of the Class I railroads in the United States. I submit this testimony on behalf of the RLEA, its members, and they employees they represent.

Among its numerous recommendations, the Administration's FY 1988 Budget calls for a 1.5% increase in Tier II railroad retirement tax rate effective January 1, 1988, and a second such increase on January

1, 1989. The Administration also proposes that 25% of the costs of vested "windfall" dual benefits be paid from the Railroad Retirement Account that is funded by the Tier II railroad retirement taxes.

The Administration's budget proposal for increasing Tier II railroad retirement tax rates is based upon a recommendation of the Chief Actuary of the Railroad Retirement Board who also concluded that "Congress may find it appropriate to allow railroad labor and management to prepare joint recommendations regarding the proportion of tax increases to be borne by employers, the proportion to be borne by employees, and what, if any, adjustments are to be made in benefits." Rail Labor endorses that suggestion of the Chief Actuary and urges upon the members of this Committee and the Congress to permit the opportunity for labor and management to resolve this problem at this time as the Congress has historically done in the past.

It is the position of Rail Labor, however, that management should bear the full cost of the 1.5% tax increases. The need for these increases has been caused by continuing reductions in jobs in the industry and reductions in entry level pay. Each of these causes is within the control of rail management. Much of the job loss in our industry results from railroads contracting out railroad work to companies not covered by the Railroad Retirement Tax Act and the selling of thousands upon thousands of miles of line to so-called short-lines that employ fewer employees and many do not consider themselves subject to the Tax Act. In addition, the railroads have insisted upon lower entry level rates for their employees. As a result, there is much less revenue going into the Railroad Retirement Trust Fund than in the recent past thereby necessitating the tax increases recommended by the Board's actuary.

Over the past few years, railroad annuitants have had their benefits cut and their taxes increased. The active railroad employees, who along with their employers financed the railroad retirement system, have had their taxes increased to the point where they now pay 13.83% of Tier II taxable compensation. Because of the complexity of the problems involved, the Congress has historically permitted rail labor and management to bargain and agree upon joint recommendations to the Congress that take into consideration the peculiar problems and difficulties confronted by active rail labor, the retired and disabled, and rail management. Congress traditionally has accorded great weight to those recommendations in its deliberations upon amendments to the Railroad Retirement System. We respectfully urge that the Congress again permit the industry to recommend to you what we at least would consider as solutions to future problems which may arise within the system.

We say "future" problems because there is no immediate crisis confronting the railroad retirement system. As the Board's Actuary has said: "the railroad retirement system's fund is expected to continue growing for several years without new legislation, even under the most pessimistic employment assumption". He then concluded that there "is no immediate danger of having to curtail benefits in the absence of additional financing". In view of this conclusion, it would seem the most appropriate course to follow in this situation would be to have labor and management negotiate joint recommendations to the Congress which could then be considered for incorporation into the law. Indeed, labor and management have met and discussed in general terms what needs to be done but because of national negotiations which have taken up so much of their time in recent months, we have not been able to provide this subject with the time and attention necessary to reach joint recommendations. The national negotiations are now behind us and we can devote the necessary time and attention to reaching agreement upon these matters. We ask that the Congress give us the opportunity to do so.

Also included in the FY 1988 Budget of the Administration is a recommendation that 25% of the costs of vested "windfall" dual benefits be paid out of the Railroad Retirement Account that is funded by Tier II railroad retirement taxes. In 1954, the Congress eliminated the so-called "dual benefit" restriction thereby allowing employees who qualified for both railroad retirement and social security benefits to receive the full benefits of both the systems. This action was taken over the objections of the entire membership of the Railroad Retirement Board and most of the railway labor organizations, including my own organization. It allowed the employees who qualified under both Railroad Retirement and Social Security to take advantage twice of the benefit formula "weighting" favoring lower income individuals. The result was that these people got a higher social security level benefit than persons with the same amount of total employment, all of which was performed under one system or the other. The Congress never completely funded the costs of the removal of the dual benefit restriction, as a result of which the unfunded portion of the payments thereby required became a direct drain on the Railroad Retirement Trust Fund. In 1974, the Congress removed the provisions for the dual benefit for the future but provided it had to be phased out through those in whom it had equitably vested. The 1974 Act authorized appropriations from general revenues for the phase-out of the dual benefits. The amounts authorized were to be sufficient to fund, on a level basis over the years 1976-2000, the dual benefit for new accruals and for beneficiaries on the rolls. It very soon became clear that the cost of the phase-out program was substantially more than the amount estimated and very substantially more than the funds appropriated by the Congress. The result was devastating to the Railroad Retirement Trust Fund. The Congress determined in 1974 that the costs of phasing out the dual benefits should be paid from appropriations to the general fund. Congress repeated that conclusion in 1981 and in 1983. In the latter year, it prohibited future payments of windfall benefits out of the railroad retirement account should there be a shortfall in appropriations from the general fund.

Significantly, in 1983, the OMB, through then Director Stockman, supported making the dual benefits a fully funded entitlement. Prior to that time OMB had consistently opposed federal funding for dual benefits but Congress, nevertheless, had provided such funding. Now OMB and the Administration want to burden the employees and the industry with further taxes to support in part at least these payments which the Congress historically and consistently assumed as a federal obligation. To accede to the Administration's request to this regard would be to contravene a Congressional policy established in 1974 and consistently followed thereafter. We respectfully submit that the Administration's request to burden the Railroad Retirement Account with 25% of the costs of the vested dual benefit payments be rejected.

We most appreciate the opportunity to appear before your Subcommittee and present our views on a subject so important to each of our active and retired members. I shall be happy to answer any questions that the members of the Subcommittee may have with regard to these issues.

Thank you.

STATEMENT OF MICHAEL J. GRISANTI, VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRISANTI, INC., LOUISVILLE, KY, ON BEHALF OF THE NATIONAL RESTAURANT ASSOCIATION

Mr. GRISANTI. Thank you, Mr. Chairman.

You have received a copy of my testimony, so what I would like to do is just summarize the important points, and I will keep my remarks brief.

Senator BAUCUS. It will be included.

Mr. GRISANTI. I would like to thank you for allowing the National Restaurant Association to appear before you today. As you know, we are the leading trade association for the food service and hospitality industry, representing 593,000 units and over 8 million employees.

I am Michael Grisanti, currently Vice President of the National Restaurant Association, and President of Grisanti, Incorporated. Our company operates eight restaurants in five states—Kentucky, Indiana, Nebraska, Colorado, and New York.

The 1988 budget proposal would and does propose that Social Security taxes on tips be paid by employers, which represents a change in the current law. This would represent a $200 million annual tax in the first year, and would, in theory, reduce the deficit. This obviously would not have anything to do with the deficit reduction, but it is, in the Social Security Account, a very separate account; so we are looking at in many ways an accounting sleight-of-hand here.

The other point I would like to make here, Mr. Chairman, is that the trust fund is currently solvent. Historically, changes have been made in Social Security taxes for two reasons: One, to increase benefits or change the benefits structure, and, two, to reetify a solvency problem. Neither of those is happening in this particular instance.

If this tax were increased, and if the employer were made to pay a matching tax on tips, the employees would not benefit. The employees currently receive full benefits based on the amount of tips that they report and based on the amount of tax that they pay into the system.

The issue of subsidy has been raised in this tax proposal. I want you to understand that we are not asking for special treatment in this circumstance. We pay a matching tax on the agreed-upon wage. We agree with our employees that there will be a tip credit, and we pay a matching tax on the amount that brings that employee's wage up to the minimum wage.

This tip or gratuity is a transaction between the guest and the employee. We as the employer play no role in that transaction. And according to Section 3111 of the Code, the FICA tax is a payroll tax. A tip transaction is not a payroll transaction.

The last point that I would like to make, Mr. Chairman, is that if this tax were enacted, it would affect small businessmen more than any others. Ninety-three percent of all tipped employees work in what in essence are small businesses, businesses that do annually less than a million dollars a year in business volume. These business units average 4.9 percent profit before tax. If this tax were enhanced, we would find that a 9-percent reduction on average would take place in these small businesses. Already these are very marginal businesses, and that 9-percent tax increase would be devastating to the industry and to those small businesses

In my own business, we have done a calculation on this tax proposal and find that on average we would be spending an additional $11,000 a year to pay a tax which would come, obviously, off the bottom line of our restaurants.

I would be more than happy to answer any questions you might have.

[Mr. Grisanti's written prepared testimony follows:]

TESTIMONY

OF

MICHAEL GRISANTI

GRISANTI, INC., LOUISVILLE, KENTUCKY

VICE PRESIDENT, NATIONAL RESTAURANT ASSOCIATION

BEFORE

THE TAXATION & DEBT MANAGEMENT SUBCOMMITTEE

OF

THE SENATE FINANCE COMMITTEE

MARCH 23, 1987

Mr. Chairman:

Thank you for giving the National Restaurant Association the opportunity to testify today before the Senate Finance Committee.

The National Restaurant Association is the leading trade association for the United States foodservice industry. Our industry is comprised of 593,000 units and employs 8 million people.

I am Michael Grisanti, a restaurateur from Louisville, Kentucky, and vice president of the National Restaurant Association. My company operates eight tableservice restaurants in five states--Kentucky, Indiana, Nebraska, Colorado and New York.

Mr. Chairman, I'd like to address one of the provisions in the President's fiscal year 1988 budget--specifically, the proposal that would require employers to pay Social Security, or "FICA," taxes on the gratuities that waiters and waitresses receive from restaurant patrons.

The Administration predicts that this proposal would generate $200 million in increased receipts during fiscal year 1988. Mr. Chairman, we see this proposal as amounting to a $200 million tax increase that would fall squarely on the shoulders of an already-burdened restaurant industry.

The Administration says it has included this provision in its budget because there is a "subsidy" for employers of tipped workers under current law. Under current law, employers pay FICA taxes on cash wages and that portion of tips considered to be wages under the federal minimum wage law. Tipped employees themselves pay FICA taxes on all tips they receive.

Mr. Chairman, there is no subsidy for restaurant employers under current law. We are not here to ask for any unique consideration. Like all other employers, we pay all the appropriate FICA taxes on the agreed-upon wages.

The central issue here is what constitutes "payroll."

Tips are simply not part of the payroll. Tip income is the result of a transaction between a restaurant guest and a waiter or waitress. Restaurant owners are in no way involved in this independent transaction. To require them to pay FICA taxes on employee income that they do not control would require a significant change in tax policy.

Tips are a unique form of income. Outside of the U.S. service sector, there exists no comparable practice. Because of this difference, Congress has recognized that tips cannot be treated in the same way as other forms of income.

Twenty-two years ago, the 89th Congress gave serious consideration to the issue of whether employers should pay FICA taxes on tips, and soundly rejected the idea. During the conference on the Social Security Amendments of 1965, conferees concluded that "tips are not considered as remuneration for employment for purposes of the employer taxes imposed by Section 3111 of the code." We see no rationale or new information to justify reversing this conclusion in 1987.

Mr. Chairman, we also oppose this tax increase because it would have the greatest impact on the operator least able to absorb it--the small business person.

Nearly 93 percent of the foodservice establishments that employ tipped workers have annual sales volumes below $1 million. This is a sales volume that hardly constitutes a major operation. Yet, since most of our tipped employees work in this segment of the industry, these smaller businesses will be the ones to feel the impact of the Administration's proposal.

The National Restaurant Association's research department has put together an illustration of how a tableservice restaurant with annual sales of $1 million would be affected by the Administration's proposal. In this restaurant, tipped employees average $3.70 per hour in tips. Currently, an employer pays $.24 in FICA taxes per hour for each tipped employee.

Under the Administration's proposal, this employer's FICA contribution would shoot up to $.41 per hour--a 71 percent increase! Although this restaurant represents neither the best nor the worst case scenario, you can see that a FICA payroll cost increase of this magnitude would impose a significant burden on smaller operators.

A 1986 study showed that this type of restaurant reports pre-tax net income of 4.9 percent. If the Administration's proposal took effect, this restaurant's pre-tax net income would decline by 9 percent. Already, tableservice restaurants have an extraordinarily high failure rate: Over half of all new restaurant operations fail within their first two years. Considering the burdens which this proposal would place on thousands of small businesses, the Administration's proposal seems foolhardy.

The proposal seems especially foolhardy in light of the fact that the $200 million generated can only go into the Social Security Trust Fund. In testimony last year before the House Appropriations Committee, the associate commissioner for management of the Social Security Administration said that for the 75-year long-range projection period, the balance of the Trust Fund falls within the range of "close actuarial balance" and that there is no need for any corrective action.

Moreover, levying this additional tax on employers will not benefit tipped employees. First, the increased payroll costs are likely to result in fewer jobs, and second, the extra taxes will not increase the Social Security benefits tipped workers are entitled to collect upon their retirement.

Finally, Mr. Chairman, let me briefly explain the financial impact of the proposal on Grisanti, Inc. Each of our restaurants employs approximately 130 people; about half of these are tipped workers. If the "FICA on tips" provision became law, it would cost *each one* of our restaurants an additional *$11,000 per year* in employer-paid FICA taxes. Although the President may not consider this a tax increase, I can assure you that those of us in the restaurant industry can view it no other way.

In summary, this proposal amounts to a tax increase which requires a significant departure from current tax policy, hurts restaurant employers, most of whom are small business people, and is of no benefit to restaurant employees.

Thank you, Mr. Chairman and members of the subcommittee, for this opportunity to appear. I look forward to answering any questions.

Senator BAUCUS. Thank you very much.

Mr. Dempsey, what do you attempt to resolve in your negotiations with rail labor, other than the division of who pays what portion?

Mr. DEMPSEY. Do you mean as to the Railroad Retirement question?

Senator BAUCUS. Yes.

Mr. DEMPSEY. Well, typically it is who pays what share of the additional tax, and what can be done with respect to the benefits structure; so that in 1983 we did all three. We had increased taxes, about 58 percent of the taxes were laid on management and about 42 percent on active employees, and then we restricted benefits.

The question of benefit restrictions is undoubtedly the most complicated, because you are dealing with vested rights, you are dealing with people on the retiree roles so you are dealing with people who are coming toward retirement.

There are a variety of possible approaches to the benefit problem that we will want to talk with the unions about.

But that is it—taxes, who shares what part of the tax increases, what are the benefit restrictions. The Administration has recommended an equal division of the 1.5 and the 1.5 percent; but that is something we ought to be able to talk about, and we need time to look at the actuarial projections of the Chief Actuary. After all, in 1985 the Chief Actuary said that the Fund was in good shape, in such good shape that part of it could be diverted to the Railroad Unemployment Fund. In 1986 he says that we are headed for bankruptcy in the next century—2003, 2005, 2007, depending on employment. What happened was this: His 1985 projections were based upon three employment assumptions. The most optimistic was 2 percent a year, down to a certain level; the midpoint was 3 percent a year; the most pessimistic was 4 percent. In 1985 we had a calamitous decline in reduction in employees, with no apparent explanation, no recession. So he went back to the drawing boards and said, "OK, my new assumptions are 3.5 percent, 4 percent, and 4.5 percent." Well, he may be right, but he may be wrong. And we need time to look at that.

Senator BAUCUS. What does it look like for 1987? What is your best guess?

Mr. DEMPSEY. I don't know; I turn to Mr. Hopkins for that, because that's more in his line. But I will bet that he doesn't know, either.

Mr. HOPKINS. No, I don't.

Senator BAUCUS. Well, what is the trend?

Mr. DEMPSEY. Well, that is the trend. We have lost 40 percent in employees since 1980—40 percent. And I don't blame the Chief Actuary for not being able to predict that; I couldn't have predicted that, and I don't think anybody in the industry could have predicted that.

Mr. HOPKINS. I can add that the average Railroad Retirement employment base was, as I recall, 338,000 in 1986. The latest figure that I have is for January of 1987, and that figure is 308,000. Now, January and February tend to be the lowest employment months in the year, so that figure could well build up as Spring and Summer come upon us; but I think one thing that is clear is that the trend fundamentally is this: Our traffic since 1980—you can look at it, it may be a little bit less if you have different measurements—let us say it is essentially flat. That is about it. We are performing that service with something like 40 percent less employees. The reason is that we are under enormous competitive pressure from the trucking industry, because of deregulation of the trucks. There has been a rate compression; our rates are down since 1980 in real-dollar terms, and we have had to take every opportunity available to reduce costs—and that isn't just employee costs, that is all costs.

Senator BAUCUS. How far along are you in your negotiations?

Mr. DEMPSEY. We have only had one or perhaps two—maybe two—preliminary discussions. So we are not far along.

Senator BAUCUS. When were they?

Mr. DEMPSEY. Oh, they started before the unions went down to their annual meetings in Miami in February, just before then; so, sometime in late January. Then I went down and spoke briefly to them in February, and we are waiting now for the unions to give us a date to get down to hard bargaining on it.

Senator BAUCUS. When do you expect to reach an agreement?

Mr. DEMPSEY. Well, I would be reluctant to guess.

Senator BAUCUS. If you are asking us not to act until you work out an agreement, it is fair for us to know how long it is going to take you to agree.

Mr. DEMPSEY. It is more than fair for you to know that. I would like to consult with the unions about that and come back. I think we would be perfectly agreeable to having Congress say, "Okay, come back to us with a report" by a date certain; I think that is more than fair.

Senator BAUCUS. What is a reasonable date for you to get back to us?

Mr. HOPKINS. I would feel much better if we could consult with our labor colleagues before answering that.

Mr. DEMPSEY. It isn't that nothing has been going on in this period. What we have been doing is getting from our actuaries and our consultants projections as to cost savings that would be associated with a variety of different changes in the program, as well as their estimates as to how reliable the Chief Actuary's estimates are as to the state of the fund. So, we have been working. And we could not really have gotten down to bargaining until just about this time, because we haven't had the data.

Senator BAUCUS. I have more questions, but I see the Senator from South Dakota here, Senator Daschle.

Do you have any questions?

Senator DASCHLE. Thank you, no, Mr. Chairman.

Senator BAUCUS. Mr. Bates, what is your reaction to some of the questions I have asked—namely, how well are the negotiations going, how long is it going to take, and so forth?

Mr. BATES. Mr. Chairman, as I stated, the railroads have complete control of the number of employees in the industry. There have been a number of things happen that contributed. There is no way the Chief Actuary at the Railroad Retirement Board could predict the amount of railroad that has been sold to short-line operators; the reduction in the number of people the short-line operator uses is tremendous. The tax base is greatly reduced because of reduced compensation to those people.

The railroads have negotiated agreements that reduce entry-level rates with almost every craft, which again reduces the tax base. The railroads make every effort to use outside contractors to perform railroad work that would be covered under the Railroad Retirement System, were it not that they are not railroad employees.

So, there are a lot of things that have occurred that have caused the great reduction in the number of employees.

Senator BAUCUS. What about the negotiations? How well are they coming along?

Mr. BATES. Well, we have had one meeting, as Mr. Dempsey said. Really, I don't think we have done any negotiating. The railroads have told us what we have got to do, and we are not convinced that that is what we are going to do, but we are willing to sit down and talk and try to come out with an agreement.

We have already paid, in reduction of benefits—we have paid our share. But we will go in and negotiate, and we will try to come up with something.

Senator BAUCUS. What is the probability that you can reach an agreement?

Mr. BATES. It depends on the mood of the carriers, I guess.

Senator BAUCUS. What is your best guess?

Mr. BATES. Oh, I think we can. It has always happened in the past. We have been able to get there.

Mr. DEMPSEY. Mr. Chairman, we agreed in 1974 with the unions and on a major restructuring in 1981 and 1983. So, the track record is good. But I think, you know, we just have to acknowledge that as in the past these are difficult issues. Whether we can agree or not, no one can say right now; but, as I say, history is in our favor.

Senator BAUCUS. Would you send this subcomittee a letter addressed to me, indicating a date by which you think an agreement can be reached?

Mr. DEMPSEY. Surely.

Senator BAUCUS. Thank you. Mr. Grisanti, isn't this agreement we worked out on tips a little strange? That is, tips are wages for the employees but self-employment income for the employers. Aren't we setting a precedent here that we should not set? Shouldn't we somehow go back and get some symmetry and organized structure back?

Mr. GRISANTI. Well, I don't know that it is precedent-setting. I think this issue was debated rather extensively back in 1965, and it was determined at that time that tips were not considered wages for payroll tax purposes. So, we are not disagreeing that employers should not pay a portion of the agreed-upon wage; we do in fact pay a matching Social Security tax on those tips that are a part of the agreed-upon wage. So, I don't think we are asking for any kind of exceptional ruling at all.

We really can't be a party to and be responsible for a transaction that we are not participating in. A tip is a transaction between a guest and an employee. The employer has really no role in that.

Senator BAUCUS. Could you flesh out a little bit more for me what you think the effect of the Administration's proposal would have on say the restaurant business generally? How many businesses would close? To what degree would it adversely affect them?

Mr. GRISANTI. I think that if you consider who is being affected by this proposed tax, it is the small businessman. Currently, those restaurants, on average earn about 4.9 percent in profit, and that's on average—some are less, and some are more. And those that are less, I think, clearly would go out of business. They can't operate in a deficit situation. So I think you would have a number of restaurants go out of business, those that are marginally profitable at this point.

I couldn't tell you the exact figure; I'm sorry, I don't have that. But when you are dealing with that small a profit margin and you talk about the effect of this legislation in essence being a 9-percent reduction in what is already a 4.9-percent bottom line, I think you can imagine the effects of that.

Senator BAUCUS. I think it is clear it would have an adverse effect.

What happened in the restaurant business when Congress enacted the 80-percent meal deduction requirement rather than the full 100 percent? You know, the industry claimed it would be a catastrophe, that nobody would go out to lunch or dinner anymore, that expense accounts wouldn't be there anymore, and that the poor old restaurants would close. As I understand it, the restaurants are doing a booming business, and the limitation hasn't had a negative effect at all. Why is that? What has happened?

I can remember looking at some estimates of what effect that would have on the industry. You know, they were pretty alarming.

Mr. GRISANTI. They are alarming. Mr. Chairman, I think there are a couple of things that are important to understand:

One, April 15 has not arrived yet this year; so a lot of people don't understand the impact of last year's taxes. This law took effect in January of 1987. I don't think we will begin to have the public understand the impact until sometime in 1988 and beyond. I don't think corporations fully understand the impact, and thus have not made any changes in their corporate entertaining policies. In essence, I believe it is really too early to tell.

Senator BAUCUS. What you are saying is that even though business men and women may be taking the meal deduction, and even though it is 80 percent, and even though people are still eating out as much as they were, you are suggesting that might change when businesses file their income taxes?

Mr. GRISANTI. I think that very much will be the case.

Senator BAUCUS. And you are suggesting that most businesses don't keep close financial control over operations at all until after they have filed their income tax return. That is a little strange, isn't it? Don't most businesses know what is going on on a monthly basis, instead of waiting until the next year?

Mr. GRISANTI. Again, all businesses use business entertaining as a form of marketing. But one huge sector who can't afford to do magazine or newspaper or television or radio advertising are small businesses.

Yes, I really believe that those people don't spend a whole lot of time worrying about tax policy; they are worrying about meeting payroll. I think that the effects for those small businesses will be felt, again, in 1988 when they begin to file their returns.

Senator BAUCUS. Thank you all very much; we appreciate your testimony.

Our final panel consists of Mr. William Burhop for the Air Transport Association; Frank Willis for the Associated General Contractors of America; and Eric Vaughn, Renewable Fuels Association.

Mr. DASCHLE. Mr. Burhop happens to be a very good friend of mine. He is the representative of the Air Transport Association and has been the Director of their office here in Washington now for some time. We are delighted he is here.

Senator BAUCUS. Well, with that introduction, Mr. Burhop, you are first.

STATEMENT OF WILLIAM BURHOP, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, ON BEHALF OF THE AIR TRANSPORT ASSOCIATION OF AMERICA

Mr. BURHOP. Thank you very much, gentlemen.

My name is William J. Burhop, and I am Senior Vice President for Government Affairs for the Air Transport Association, and I would appreciate it if the entirety of my statement was included in the transcript.

Senator BAUCUS. It will be included.

Mr. BURHOP. ATA represents airlines providing most of the air travel throughout the United States. We appreciate the opportunity to express our views concerning the extension of the excise taxes on air transportation that are reposited in the Airport and Airway Trust Fund.

Under current law there is an 8-percent tax on the purchase of domestic air transportation, a 5-percent tax on the amount paid for the domestic transportation of cargo, and a tax of $3.00 for air transportation from the United States to points outside the country. These taxes provide most of the revenue for the Airport and Airway Trust Fund to finance capital improvements to the airway system as well as to provide funding for the airport improvement program. A limited portion of the current costs of operating and maintaining the airway system is also paid out of this fund.

This structure was originally enacted in 1970, to provide a separate and continuing source of funding for the needed improvements to the airport and airway system. The programs and the taxes were reauthorized in 1982, after the Administration and Congress determined that there was an increasing need for substantial improvements to the system to augment safety and capacity. These improvements, outlined in a $12 billion National Airspace System Plan, included new computers and other equipment necessary to accommodate anticipated growth in the system.

In order to provide the funds for the program, the Administration requested that the excise taxes on transportation be reenacted at their previous levels of 8 percent, 5 percent, and $3.00.

The air carriers and the aviation community at that point supported the Administration's request because of the clear need to enhance systems safety and increase system capacity to provide for the anticipated growth in aviation demand. However, things have not gone as planned.

At the end of Fiscal Year 1986, the Trust Fund had a cash balance of $8.6 billion and an uncommitted surplus of $4.3 billion. It is expected that at the end of fiscal year 87 the uncommitted balance will be approximately $5.6 billion. This is not the forum in which to delineate the present problems in the airport and airway system, let alone explain our concerns about the system's inability to cope with projected growth. Suffice it to say the airline industry is far from convinced that reauthorization of the existing statutory program or the tax structure will resolve the underlying funding and management problems existent at the FAA.

It was because of similar concerns that this committee included a so-called trigger tax mechanism in its 1982 reauthorization legislation. We actively participated in an unsuccessful effort to convince the House taxwriting committee to permit such a trigger-tax approach.

The trigger-tax concept, if approved, would ensure that in the future transportation tax receipts and disbursements could be brought into better balance. It would also be beneficial to correct what has become a historic overpayment of taxes by passenger shippers and users.

Now the Administration is asking the Congress to extend the present taxes for two more years, beyond December 31, 1987, and also to reauthorize the spending programs for two years beyond September 30, 1987, when they also expire.

The air carriers believe that the taxes on transportation should be related to authorized spending levels, and ask that the committee not make a decision on these taxes until the Congress has taken action on the spending program. In this manner, the levels and the durations of the taxes can be related to the planned expenditures of the airport and airway system and take into account consideration of the high Aviation Trust Fund surplus.

In connection with the examination of the operation and management of the airway system, a number of proposals will be considered by the Congress. The air carriers are very disturbed by the present system and are proposing a significant change in both the funding and management of the system for the consideration of the Congress.

ATA has proposed a way to better fund and manage today's system while planning effectively for tomorrow's. Our proposal is what we call the National Aviation Authority, and it would be a new Congressionally-chartered government corporation that would be self-sustaining through user fees and would be free from any of the stifling government constraints on personnel and procurement but maintain Federal Government control of vital safety functions. The outline of that proposal is included as Attachment-A to my statement.

The ATA and its member carriers ask that this committee defer action on the Administration's proposal to extend the excise taxes on air transportation until the Congress has determined the future approach to airport and airway system requirements.

Thank you, Mr. Chairman. I would be pleased to address any questions you might have.

Senator BAUCUS. Thank you very much, Mr. Burhop.

Next, Mr. Willis.

[Mr. Burhop's written prepared statement follows:]

Statement of William J. Burhop
Senior Vice-President, Government Affairs
Air Transport Association of America to the
Committee on Finance
United States Senate
On the Administration's Proposals for Reauthorization of Airport and Airway
Trust Fund and Excise Taxes
March 23, 1987

The Air Transport Association of America (ATA) represents airlines providing more than ninety percent of the scheduled passenger miles flown and most of the air service provided in the United States.

We appreciate the opportunity to express the views and concerns of the air carrier members of ATA on several tax proposals included in the Administration's Budget for the fiscal year 1988. The proposals of significant concern are:

-- The extension of the excise taxes on air transportation that are deposited in the Airport and Airway Trust Fund;

-- The proposed $1 ticket writing charge to finance the U.S. Travel and Tourism Administration; and

-- The extension and expansion of international traveler and shipper processing fees.

Extension of the Excise Taxes on Air Transportation

Under current law, specifically Section 4261 of the Internal Revenue Code, there is an 8% tax on the purchase of domestic passenger air transportation, a 5% tax on the amount paid for the domestic air transportation of cargo and a tax of $3 for air transportation from the United States to points outside the country.

These taxes along with the taxes imposed on fuel used in non-commercial aviation provide the funds for the Airport and Airways Trust Fund to finance capital improvements to the airway system as well as to provide funding for the Airport Improvement Program. A limited portion of the current costs of operating and maintaining the airway system is also paid out of this fund.

The Trust Fund and the current taxes on air transportation were originally enacted in the Airport and Airway Revenue Act of 1970 to provide a separate and continuing source of funding for the needed improvements to the airport and airway system. The programs and the taxes expired in 1981 and were reenacted in 1982 after the administration and the Congress determined that there was an increased and continuing need for substantial improvements to the system to augment safety and capacity. These improvements, outlined in the $12 billion airport and airway reorganization and modernization effort known as the National Airspace System Plan (NAS Plan) included new computer systems and other equipment necessary to accommodate anticipated air travel growth. The NAS Plan contemplated a reliably funded multi-year spending program utilizing the Trust Fund revenues to put the equipment in place.

In order to provide the funds for the program, the Administration requested that the excise taxes on air transportation be reenacted at the previous levels (i.e., 8%, 5% and $3, and placed in the Airport and Airway Trust Fund). Additionally, the Administration requested that a five-year program be authorized with appropriate spending levels to fund the NASP.

The air carriers and the aviation community supported the Administration's request because of the clear need to enhance system safety and increase system capacity to provide for the anticipated growth in aviation.

However, things have not gone as planned. At the end of fiscal year 1986 the Trust Fund had a cash balance of $8.6 billion and an uncommitted balance of $4.3 billion. It is estimated that at the end of Fiscal Year 1987 the uncommitted balance will be approximately $5.6 billion.

This is not the forum in which to delineate the present problems in the airport and airway system, let alone explain our concern about the systems's ability to cope with projected growth. Suffice to say, the airline industry is far from convinced that reauthorization of the existing statutory program or tax structure will resolve the underlying funding and management problems.

In any case, spending requests for the capital programs have fallen short of authorizations by about $1.3 billion and appropriations have fallen short of budget requests by $850 million. Taken together, the shortfall is more than $2 billion and the uncommitted Trust Fund surplus has grown to an unconscionable level. It was because of these concerns that this Committee included a so-called trigger tax mechanism in its 1982 reauthorization legislation. We actively participated in an unsuccessful effort to convince the House tax writing committee to permit the trigger tax approach. The trigger tax concept if approved could assure that, in the future, transportation tax receipts and disbursements could be brought into better balance. It would also be beneficial to correct what has become a historic overpayment of taxes by users.

The Administration is asking the Congress to extend the present taxes for 2 years beyond December 31, 1987, and to reauthorize the spending programs for two years beyond September 30, 1987, when they each expire.

Moreover, the administration bill includes a proposal that contemplates defunding (sometimes erroneously referred to as defederalization) of airports and removal of the statutory prohibition on head taxes. We strongly oppose the defunding proposition, particularly when such a proposal is linked to removal of the head tax prohibition. ATA's objections to defunding and head taxes are based on the following considerations:

1. Defunding would impair coordination between the FAA and those airports not participating in the federal grant program regarding the efforts to meet the needs of the nation's aviation system. Separation of any of the major airports from the federally sponsored planning and development program would be deterimental to airport and airway system development.

2. Passengers and shippers have already paid federal user taxes to fund needed airport development, and a surplus of about $5 billion exists in the Aviation Trust Fund. Those funds should be made available for airport development, not arbitrarily withheld or ignored. Further, no additional charges on users are warranted given the enormous Trust Fund resources already collected in advance.

3. Passengers using defunded airports would continue to pay the federal ticket tax, and thus be subject to double taxation if a head tax were authorized. Worse yet, the Administration is proposing that entitlement funds turned down by defunded airports should return to the Trust Fund, and not be available for system improvements. And airports interests are proposing that a head tax be authorized even if an airport receives a federal grant. ATA believes that airports have a variety of funding alternatives from federal, local, and user sources, and do not need a new federally-authorized funding source which raises so many questions and concerns.

4. Collection of head taxes by airlines, on behalf of airports, would be extremely burdensome to the complex system of interline ticketing and revenue accounting arrangements among airlines and travel agents worldwide. The difficulties inherent in collecting a head tax for passengers using a particular airport from the over 29,000 U.S. travel agency locations handling hundreds of millions of documents issued by over 167 airlines cannot be underestimated.

ATA believes that the reauthorization of the airport program should focus on enhancements which will promote the goal of the aviation system rather than on novel proposals which fragment the airport development environment.

The air carriers also believe that the taxes on air transportation should be related to authorized spending levels and ask that the Committee not make a decision on these taxes until the Congress has taken action on the spending program. In this manner the levels and duration of the taxes can be related to the planned expenditures for the airport and airway system and take into consideration the high Aviation Trust Fund surplus.

In connection with the examination of the operation and management of the airway system, a number of proposals will be considered by the Congress. The air carriers are very disturbed with the present system and are proposing a significant change in both the funding and management of the system for the consideration of the Congress. The outline of our proposal is included for your information as Attachment A.

The ATA and its member air carriers ask that this Committee defer action on the Administration's proposal to extend the excise taxes on air transportation until the Congress has determined the future approach to airport and airway system requirements.

Proposed $1 International Ticket-Writing Charge

The Administration has proposed a $1 charge per ticket for international travel to and from the United States as a "user fee" to fund the United States Travel and Tourism Administration's current budget of $12 million. The

Administration plans that receipts in excess of the current program budget will be deposited in the Treasury. The ATA estimates that such a fee applied on the same basis as the customs and INS User Fee, will raise approximately $18-20 million from airline passengers in FY 1988.

The air carriers are opposed to such a fee because it is in excess of the costs of the program and because the USTTA program benefits a large number of people, business and indeed the nation as a whole.

Foreign tourists to the U.S. visit many places and purchase goods and services throughout the country. These expenditures increase the GNP, reduce the balance of payments deficit and result in employment of a large number of U.S. citizens. The nation as a whole benefits from such a program. To identify the air carriers as the only beneficiary of the USTTA programs is clearly wrong.

Extension and Expansion of International Travel and Shipper Processing Fees

In addition to the excise taxes and the proposed $1 ticket-writing charge (discussed previously), international travelers are currently subject to a variety of user fees. Separate $5 fees are in place with regard to both Customs and Immigration processing of travelers. In addition a new $3 user fee is likely to be proposed by the Administration with reference to passenger processing by the Animal and Plant Health Inspection Service (APHIS) of the Department of Agriculture.

The airlines believe that these fees are inappropriate for three reasons:

First, the principle underlying the imposition of any user fee by the government is that a direct charge to the user is appropriate because it is the user rather than the general taxpayer who is the beneficiary of a particular service. The user pays for the service which he or she opts to receive. As such, user fees provide a convenient and appropriate means to finance specialized government services which a user elects to employ. As is noted in the Budget of the United States Government, Fiscal Year 1988, "User fees increase efficiency of service delivery by reaching those willing to pay. Cost-based user fees may also provide an incentive for the private sector to provide comparable service at a lower cost." *Id*. at 2-47.

We would submit that while international travelers are processed by the various law enforcement and revenue collection agencies currently charging or advocating user fees, there is no plausible argument which suggests that these passengers are somehow the beneficiaries of any governmental services which they elect to receive. The benefit of these governmental functions is clearly and directly one of utility only to the general taxpayer. As such, it is inappropriate and illogical to employ a passenger-based user fee mechanism in this context. These are general governmental expenses which should be paid for out of general revenue.

Even were one to concede that international travelers somehow benefit from Customs/Immigration/APHIS processing, the second reason the air carrier members of ATA find these fees objectionable is that, as currently structured, they bear no relationship to the government's costs for providing the processing in question.

The FY '88 budget proposed by the Administration for INS, for example, would return fifty percent -- $75 million -- of the user fee charges paid by international travelers to the Treasury general fund. At the same time, of course, an effort is underway to institute a $3 APHIS user fee expected to generate $76 million while only a fraction of that amount is expended to provide the necessary APHIS inspections of international travelers.

The ATA carriers believe it is unconscionable for the government to generate substantial revenue under the guise of supposedly cost-based user fees. To the extent that any user fees are charged, we believe that the revenue must flow directly and exclusively to pay the costs of the governmental function involved.

Third, and finally, we find these fees objectionable to the extent that they were imposed with assurances of improved government capabilities for the timely and efficient processing of travelers and that improvement is not forthcoming. While it is difficult to determine from figures currently available, it does not appear that processing capabilities will be significantly improved as a result of the nearly $300 million air travelers will contribute in the form of user fees.

The Customs Service proposed budget for FY88, for example, calculates a $449 million user contribution (from both international travelers and shippers) while calling for a reduction in inspection and enforcement personnel of some 2000 full-time positions. It is difficult if not impossible to believe the passenger processing will be improved under these circumstances.

The airlines recognize that the reality of budget deficits has forced the acceptance of creative funding mechanisms for a variety of government programs. User fees are one such mechanism which, we believe, the public will accept to the extent that they are honestly employed. While we do not endorse user fees as a means of financing essential government services such as international passenger processing, we recognize that this approach provides a short-term solution to a significant problem.

We would ask that this Committee consider the following to be absolutely essential characteristics of any user fee program and that no consideration be given to the extension of any such program which does not incorporate these principles:

1. The number of user fee funded programs should be kept to an absolute minimum and the collection methods should be as simple as possible;

2. Any user fee charged must be based, as precisely as possible, on the true cost of providing government personnel and equipment to meet the particular need;

3. All user fee revenues should be dedicated exclusively to the program through which they are generated; and

4. Every effort should be expended to make user fee funded programs as efficient as possible.

We would suggest that in the absence of adherence to these principles, no consideration should be given to the extension of either the Customs or INS user fee program currently under consideration or the adoption of any new program. By the same token we do not believe that the so-called technical correction to the Custom's ad valorem cargo processing charge should not be considered favorably until such time as these principles are incorporated.

On behalf of the air carrier members of the Air Transport Association we appreciate the opportunity to submit these comments and will, of course, respond to any further questions which the Committee might wish to raise.

Air Transport Association
Testimony on Reauthorization
Attachment A

Industry Recommendations for Future Management and Funding of Federal Aviation Administration Functions

For the last two years, the major U.S. airlines have been studying how to devise a better approach to the development and delivery of ATC services. This effort was driven by the industry's frustration over the inadequacy of the existing infrastructure and the inability of the FAA to respond to the forces of a competitive marketplace. This service failure is directly linked to the byzantine system of funding the ATC system which, at once, fails to fund the system properly while building a massive trust fund surplus.

Through their trade association, the Air Transport Association, the airlines have studied and decided to pursue the creation of a wholly owned federal corporation for a more business-like operation that can meet aviation growth requirements and assure maximum effectiveness and safety of the system. Under that plan the corporation would be self-sustaining on the basis of user fees, at the levels currently flowing to the trust fund, with authority in the corporation to adjust fees to meet needs. In addition, the corporation should have borrowing authority, employ government personnel outside of the Civil Service, and be authorized to utilize business type procurement practices. As originally envisioned, the scope of the corporation would include all ATC components, including Research and Development, and, with the concurrence of the airport community, the airport grant program; FAA safety functions would not be included. Existing arrangements between the military and the FAA would be maintained by the new Authority, and all services provided by either to the other would be reimbursable. The relationship between the NTSB and the Authority would be the same as the NTSB now has with the FAA with respect to air traffic control issues within the Authority's jurisdiction.

To verify the airlines' initial assessment of problems and solutions, a study was commissioned by ATA in December of 1985 from the National Academy of Public Administration (NAPA). NAPA's findings did validate ATA's assessment of the problems, but suggested a federal corporation with greater scope and different oversight and funding characteristics. This study was completed in March 1986 and recommended that all of the existing FAA, including safety, (with the exception of the Washington airports) be placed under a new Federal Authority outside of the Department of Transportation, but subject to the policy control of the Secretary. The Authority would bemanaged by a single CEO appointed by the President and confirmed by the Senate for a fixed term. In addition, an Advisory Board would be utilized to represent user, airport, banking, local government and aviation technology views. The NAPA report recommended that funding for the Authority be derived from user fees through public ratemaking, subject to the approval of the Secretary of Transportation.

After a full exploration of the NAPA study and the original ATA report, the Board of Directors of ATA, at its meeting in June 1986, adopted the following recommendations which outline its position on the structure and authority of a new federal entity.

Scope

The new federal Authority should incorporate, at a minimum, the management and funding of the ATC system, including Flight Service Stations and Research and Development programs. It should also include the airports functions, provided the airport community is in agreement. It would not include safety and regulatory authorities, and would assume and preserve all of the FAA's existing relationships with the Department of Defense and the National Transportation Safety Board.

Since the airport community is not united in its agreement to include airport functions in a federal corporation, ATA's proposal would provide for a transfer of funds to the residual FAA from the user fee revenues to fund the airport grant program.

Funding

The Authority will be self-sustaining, funded by user fees which, for the first two years, will remain at current tax levels. Thereafter, pursuant to informal rulemaking subject to judicial review as provided in the Administrative Procedures Act, rates would be adjusted to offset expenses, in continuing proportion to current tax levels. The Authority would be empowered to borrow funds and to employ other federal agency services and make its own available on a reimbursable basis.

Trust Fund

Legislation should seek a full transfer of the existing Trust Fund balance to the new authority along with all system assets.

Management

The Authority would be under the control of a strong Chief Executive Officer appointed by the President with the advice and consent of the Senate for a 10 year non-renewable term. Qualifications for the position would be established in the statute which would also provide for an attractive level of compensation and excellent retirement benefits. The CEO would not be subject to the policy control of the Department of Transportation and would be removable only for cause.

Advisory Board

There would be a Policy Advisory Board which would meet at least semi-annually but would not have governing powers, consisting of the Secretaries of Transportation, Defense and Commerce, and the Chair and ranking minority members of the Senate and House Aviation Sub-Committees.

In addition to the Advisory Board, there would be a Technical Advisory Committee of users and other interests to provide appropriate input to the Authority.

Liability

Consistent with the Government Corporation Control Act, liability would be in accord with the provisions of the Federal Tort Claims Act. Litigation authority would rest in the Department of Justice and settlement or judgments paid from Treasury general funds as is now the case with the FAA.

Timing

The airlines believe that the status quo is not likely to change without decisive action utilizing the window of opportunity provided by the expiration of the Airport and Airway Improvement Act provisions. Through ATA, the airlines are preparing and circulating draft legislation to establish such an Authority and hope to have hearings on it this year. The ultimate goal is to achieve enactment of such legislation by the expiration of the current Act in October, 1987.

022587

STATEMENT OF FRANK E. WILLIS, WILLIS CONSTRUCTION, FLORENCE, SC, ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ACCOMPANIED BY JOHN R. GENTILLE, DIRECTOR, HIGHWAY DIVISION, AGCA

Mr. WILLIS. Thank you very much.

I am Frank Willis, a highway contractor from Florence, South Carolina. I am representing the Associated General Contractors of America, a trade association consisting of more than 32,500 firms including 8400 of America's leading general contracting companies which are responsible for the employment of more than 4 million individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal utilities' facilities.

In our submitted statement, AGC speaks to three issues: First, AGC supports the Administration's proposal to repeal the current tax exemption for gasohol. Second, our testimony calls for an extension beyond December 31, 1987, of the Aviation User Fee, which supports the Airport and Airway Trust Fund. And third, AGC expresses support for the removal of the Highway Trust Fund and the Airport and Airway Trust Fund from the unified budget.

With regard to gasohol, AGC has long called for an end to gasohol exemption from six cents of the nine-cent federal excise tax on motor fuel. AGC strongly believes that subsidizing the gasohol industry at the expense of the nation's highways and bridges is not sound public policy. It violates the user fee principle of the highway program, and the Highway Trust Fund simply cannot afford it. If the gasohol industry must continue to be subsidized for agricultural, energy, or environmental reasons, the subsidy should come from those programs and not the Highway Trust Fund. A vehicle powered by gasohol contributes to the wear and tear of our highways and bridges the same as a vehicle powered by gasoline or diesel fuel. Both vehicles should pay their fair share of the highway user fees.

The current exemption for gasohol significantly reduces revenues going into the highway trust fund. In Fiscal Year 1987, the Federal Highway Administration estimates that the loss will amount to approximately $450 million, and by Fiscal Year 1991 the loss could increase to approximately $510 million.

Removal of the gasohol exemption is an issue on which there is nearly unanimous agreement among highway users. The projected loss from this exemption of several billion dollars in federal and state highway revenue over the next few years is viewed as a most serious problem by all those concerned with maintaining a good highway system. The removal of the gasohol exemption would provide close to one-half billion dollars a year in much needed revenues to the Highway Trust Fund.

Accordingly, AGC urges the Finance Committee to report out legislation repealing the current fuel tax exemption for gasohol.

On the issue of extending aviation user fees, AGC urges the Finance Committee, at the appropriate time, to report out legislation extending the Federal Government's authority to continue collecting and depositing into the Airport and Airway Trust Fund the 8-percent airline ticket fee and the other aviation user fees beyond their December 31, 1987, expiration date. The extension of these fees will be necessary to support new authorizations for the airport and airway improvement programs. Legislation providing these authorizations will be advanced in the coming months by the congressional committees of jurisdiction.

On the matter of removing transportation trust funds from the unified budget, AGC supported such efforts in the House of Representatives in the last Congress and will support such efforts in the future. AGC believes the inclusion of these dedicated trust funds in the unified budget provides an irrestible incentive for Congress and the Administration to limit obligational expenditures from these funds below levels they could otherwise support, thereby allowing for additional spending in general funded programs without any apparent impact on the deficit.

The problem with this situation is that transportation users contribute to and support these funds in the belief that they will fully benefit from their user-fee contributions. AGC is convinced that public support for the much needed transportation infrastructure improvement programs financed by these trust funds will erode as the public becomes increasingly aware of the fact that they are not receiving the full benefits of their investments.

Thank you.

Senator BAUCUS. Thank you, Mr. Willis.

Mr. Vaughn, your turn.

[Mr. Willis's written prepared testimony follows:]

Statement of
The Associated General Contractors of America
Presented to the
Committee on Finance
United States Senate
on the Subject of
Revenue Increases Proposed
in the President's Budget

March 23, 1987

AGC is:

- More than 32,500 firms including 8,400 of America's leading general contracting firms responsible for the employment of 4,000,000-plus employees;
- 106 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities

The Associated General Contractors of America represents more than 32,500 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 4,000,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities.

This statement of the Associated General Contractors of America:

1. Supports repeal of the current tax exemption for gasohol, since the exemption violates the user fee principle of the highway program and will result in approximately a $450 million loss to the Highway Trust Fund in 1987 alone;

2. Supports the extension beyond December 31, 1987 of the aviation user fees, which are appropriated to the Airport and Airway Trust Fund, and which support the Airport and Airway Improvement Programs, scheduled to be reauthorized by the Congress this year; and

3. Supports removal of the Highway and Airport and Airway Trust Funds from the federal unified budget, and the exemption of these funds from sequestration orders under the Balanced Budget and Emergency Deficit Control Act of 1985.

1. Repealing Exemptions from the Federal Fuel Tax

AGC has long called for an end to the current tax exemption for gasohol. AGC strongly believes that subsidizing the gasohol industry at the expense of the nation's highways and bridges is not sound public policy. It violates the user fee principle of the highway program, and the Highway Trust Fund simply cannot afford it. If the gasohol industry must continue to be subsidized, the subsidy should come from general revenues. A vehicle powered by gasohol contributes to the wear and tear of our highways and bridges the same as a vehicle powered by gasoline or diesel fuel. Both vehicles should pay their fair share of highway user fees.

AGC believes that the gasohol exemption seriously undermines the user fee base of the Highway Trust Fund. Gasoline and diesel users are subsidizing highway use by gasohol users. The large federal subsidy goes to a relatively few gasohol producers. In fact, the Federal Highway Administration estimates that about half the production is from one domestic producer.

The current exemption for gasohol significantly reduces revenues going into the Trust Fund. In fiscal year 1987, the Federal Highway Administration estimates that the loss will amount to approximately $450 million, and by fiscal year 1991 the loss could increase to approximately $510 million. The gasohol exemption is of particular concern since gasohol is being supported by general exemptions from both federal and state highway user taxes and the Agriculture Department's corn subsidy program for ethanol producers. Taken in combination, AGC estimates that government subsidies total about $1.28 per gallon of ethanol--60 cents federal gas tax subsidy, 30 cents average state gas tax subsidy, and 38 cents corn program subsidy. With ethanol currently selling for about $1.00 per gallon, government subsidies therefore exceed the price of the product by over 25 percent.

The gasohol exemption provided by the federal government has also been adopted by states. State revenue losses due to gasohol exemptions are estimated at over $300 million in 1985. The combined federal and state revenue loss was nearly $750 million in 1985. Because of this severe drain on revenues, states have begun to restrict the gasohol exemption. In the last year, 12 states eliminated, reduced, or restricted their exemptions.

Removal of the gasohol exemption is an issue on which there is nearly unanimous agreement among highway users. The projected loss from this exemption of several billion dollars in federal and state highway revenue over the next few years is viewed as a most serious problem by all those concerned with maintaining a good highway system. The removal of the gasohol exemption would provide close to one-half billion dollars a year in much-needed revenues to the Highway Trust Fund.

Accordingly, AGC urges the Finance Committee to report out legislation repealing the current fuel tax exemption for gasohol.

2. Extension of the User Taxes Supporting the Airport and Airway Trust Fund

The situation facing our nation's airport and airway system is becoming critical. According to the Federal Aviation Administration, more than 650 million passengers are expected to fly on scheduled commercial airlines each year by 1997. This represents an astounding 66 percent increase from the 391 million passengers which the FAA estimates flew on commercial airlines in 1986.

During the same time period, the country's civil aircraft fleet is expected to grow to more than 250,000, as air carriers increase their fleets by about 1,000 airplanes to meet the anticipated demand for air travel, and as another 30,000 general aviation aircraft come into operations.

The availability of safe and efficient air transportation depends largely on the continued investment in airport capital development. This will require lengthening and strenghtening runways and building new terminals, gate space, hangars and service facilities. The FAA estimates that a total of $24.3 billion in capital development will be required through 1995 to meet the increases in demand for air travel. However, the FAA's estimate includes only the costs of those projects that are eligible to receive federal funding. A more realistic assessment of the total capacity improvement needs is provided by the American Transportation Advisory Council in its ATAC-III report. According to the report, "at least $27 billion will be needed to fund the required capital improvements in the nation's airports over the period 1987-1995."

Notwithstanding the concern over the federal budget deficit, it must be emphasized that the Airport Improvement Program and the other federal aviation programs are financed entirely from the Airport and Airway Trust Fund. The Trust Fund is supported by the 8 percent airline ticket tax and other fees collected from the users of our aviation system in keeping with the sound fiscal policy that users of the system should be the ones to pay the costs. This "pay-as-you-go" system has worked successfully.

Moreover, the monies that have been spent on our nation's airport and airway system have never contributed a penny to the federal deficit. User fees are collected from the nation's aviation users, placed in the Airport and Airway Trust Fund and dedicated, by law, to be spent on the nation's airport and airway system.

Accordingly, AGC urges the Finance Committee to report out legislation extending the Federal government's authority to continue collecting and depositing into the Airport and Aviation Trust Fund, the 8 percent airline ticket fee and the other aviation user fees beyond their December 31, 1987 expiration date. The extension of these fees will be necessary to support authorizations for the Airport and Airway Improvement Programs, likely to be extended by the Congress prior to September 30, 1987.

3. Removing the Airport and Highway Trust Funds from the Federal Unified Budget

AGC also supports removing the Highway and Airport Trust Funds from the federal unified budget. The Highway and Airport Trust Funds are self-supporting since all of their resources come from user fees paid by users of the transportation system, not the general taxpayer. The amount paid in depends on the extent of the use by the individual user. The dedicated funds cannot be used for purposes other than transportation improvements as provided by law. Any budget-enforced "savings" cannot be used to fund other programs.

Unlike open-ended entitlement programs, highway and aviation spending is limited by authorization legislation regularly passed in both houses and signed into law. These authorizations, unlike those for general-funded programs, amount to far more than a mere "hunting license" for appropriations up to a given level. The authorizations provide contract authority, a form of direct spending authority comparable to appropriations. Accordingly, they receive the same degree of scrutiny as appropriations acts and can be relied upon to provide the same degree of fiscal restraint as is provided by appropriations acts in the case of general fund programs.

Accordingly, AGC encourages the Finance Committee to support removal of the Highway and Airport Trust Funds from the federal unified budget, and the exemption of the Funds from sequestration orders under the Balanced Budget and Emergency Deficit Control Act of 1985.

STATEMENT OF ERIC VAUGHN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RENEWABLE FUELS ASSOCIATION

Mr. VAUGHN. Mr. Chairman, thank you very much.

My name is Eric Vaughn. I am the President and Chief Executive Officer with the Renewable Fuels Association, the national trade association for the domestic ethanol industry. I would ask that my written comments be included as part of the official record, and I would like to summarize my comments in the interest of time.

Senator BAUCUS. It will be included.

Mr. VAUGHN. Thank you.

The Renewable Fuels Association represents the nation's 100 ethanol producers, producing ethanol in 22 states and selling ethanol in 42 states around the country. We represent a total private sector investment of about $2 billion and a total government investment in the form of loan guarantees and cooperative commitments in the range of about $500 million.

The partial exemption for the federal excise tax exemption for ethanol blended fuels has provide the domestic ethanol industry with essentially the market growth, the market opportunity, the market expansion that has taken place over the last six years with ethanol sales in the United States.

In 1979, 10 million gallons of ethanol were produced in the United States. Incidentally, the cost of those gallons was about $2.15 a gallon at that time. This past year 1986, the domestic ethanol industry produced and marketed approximately 750 million gallons, and the average cost of production has fallen to somewhere in the range of about $1.25 to $1.30 a gallon. That was enough ethanol, in 1986, to be blended with approximately 7.5 billion gallons of total ethanol-enhanced gasoline.

Every year for the last seven years the Reagan Administration has, at one time or another, proposed the repeal of the partial exemption for ethanol-enhanced fuels. Most recently, in the Tax Reform Bill, both the House and the Senate and eventually the President signed a measure that would have extended and maintained the ethanol exemption through 1992. Recently both the House and the Senate have approved legislation reauthorizing the Federal Highway Trust Fund, which included the continuation of the exemption through 1992.

It is basically the position of the industry that the Government made a commitment, a 12-year commitment, to maintain a partial exemption for ethanol-enhanced fuels, and on the basis of that commitment the private sector invested its $2 billion and created the promise of fuel ethanol.

When we begin to look back, or if we do look back, at why we have an ethanol industry today, it was created at a time when there was tremendous concern about our energy import situation, our growing dependence on foreign sources of energy. Mr. Chairman, you are no stranger to these numbers, but today our imports picture looks in many cases much worse than it did in 1973 and 1979. Average imports are around 7 million barrels a day today coming in from foreign sources, compared to about 4.7 million barrels about a year ago. Our present import level is over 40 percent—

much higher than it was in 1973 or 1979. Our investment in seeking new sources of oil and natural gas in this country are down 44 percent. Our active rig count has fallen to 761 active rigs, from a high in 1981 of approximately 4,500. And employment in the oil industry today has fallen off 260,000 jobs in just a year and a half.

Ethanol provides the oil industry, the gasoline marketers in this country with the cleanest-burning highest-quality octane enhancer on the market today. As a blend, it is fully warrantied by all major, in fact all, automobile companies—foreign and domestic—selling in the United States today.

Its agricultural benefits are irrefutable. A 300-million bushel grain market has been established in this past year for grain to ethanol, adding approximately $900 million to farm income and, very importantly, lowering farm program costs on the agriculture side of the ledger by approximately $600 million a year.

I very quickly mentioned octane. It has become the single most important issue in the oil and gasoline industry today—the search for octane to provide a higher octane burning fuel for today's automobiles.

This also sort of brings us to an environmental concern and a very serious one. In response to the phase-down in lead, the oil companies, the gasoline marketers, are using much more of what is called an "aromatic," or aromatic syngerfuel—benzene, toluene and xylene. All three are either known carcinogens or mutanogens.

Ethanol competes not with gasoline in the marketplace but with octane in the marketplace today. An increased use or an increased program of ethanol use for octane enhancement could dramatically lower carbon monoxide and hydrocarbon tailpipe emission levels in all our major cities. In fact, Denver, Phoenix, Albuquerque and now even Chicago is considering a program that would dramatically increase the use of ethanol fuels to improve our air quality.

We ask the Senate Finance Committee—as we have unhappily had to ask for seven straight years—that you once again please repeal or stand firm in opposition, reject the President's proposal with repeal of the partial excise tax exemption for ethanol fuels, and allow the ethanol industry to reach its full potential.

Mr. Chairman, Thank you very much.

[Mr. Vaughn's written prepared statement follows:]

Renewable Fuels Association
201 Massachusetts Avenue, N.E.
Suite C-4
Washington, D.C. 20002
(202) 543-3802
TELEFAX: (202) 543-6925

Eric Vaughn
President/Chief Executive Officer

REMARKS OF
ERIC VAUGHN
PRESIDENT & CHIEF EXECUTIVE OFFICER
RENEWABLE FUELS ASSOCIATION

BEFORE THE
SENATE COMMITTEE ON FINANCE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

WASHINGTON, D.C.
MARCH 23, 1987

On behalf of the members of the Renewable Fuels Association, the national trade association for the domestic ethanol industry, I want to thank you for this opportunity to testify before the Members of the Senate Committee on Finance on the impact the Reagan Administration's fiscal year 1988 budget proposals will have on the U.S. ethanol industry.

The domestic ethanol industry strongly opposes the Administration's proposal to terminate the six cent federal excise tax exemption for ethanol enhanced gasoline six years ahead of schedule. Under current law, the partial excise tax exemption for ethanol blended gasoline is scheduled to expire at the end of 1992.

We also disagree with the reported "budget savings" that the Administration states could result from the elimination of the federal excise tax incentive for ethanol enhanced gasoline. Each year the Federal government saves two dollars in lower federal farm program costs for every one dollar that is not collected by the Highway Trust Fund.

Since 1981 when the ethanol excise tax exemption was enacted, more than $2 billion in private sector resources have been invested in the construction of over 100 ethanol production facilities in the U.S. These investments were made in a good-faith response to an appeal from the Congress and the Administration to achieve increased energy security. These investments were also made in reliance upon the continuation of a partial exemption from the gasoline excise tax through 1992.

OCTANE
INDUSTRY
ENVIRONMENT
NATIONAL SECURITY
AGRICULTURE
CHEMICALS
JOBS

A REALITY TODAY

In addition to private sector investments, over $500 million in federal loan guarantees and cooperative commitments have been made to numerous ethanol facilities. The elimination of the six cent federal excise tax exemption would essentially shut down the production of ethanol in the United States after only six years of growth and development. There is no question that the rejection of the Administration's budget proposal to eliminate the federal excise tax exemption for ethanol blended fuels by the Senate Finance Committee will enable the domestic ethanol industry to reach its full potential and prevent the loss of nearly 100 ethanol production facilities and the loss of $2.5 billion in public and private sector funds commited to them.

Background:

The domestic fuel ethanol industry came into existence in the late 1970's in response to gasoline shortages and the need for alternate sources of liquid fuel to reduce dependence on foreign oil. While ethanol was originally used to extend supplies of petroleum-based fuels, ethanol has become one of the most valuable additives available to boost gasoline octane. The addition of 10% ethanol to gasoline raises the octane of the gasoline by an average of 3 full octane points.

Despite falling oil prices and the glut of oil in the world market, ethanol production and use has significantly increased primarily due to the demand for premium unleaded fuel, continued government support, and federal environmental regulations on other octane enhancers such as lead.

By the end of 1986 ethanol enhanced gasoline sales had grown to represent nearly 8 percent of the total motor fuel market in the U.S. In 1986, 750 million gallons of ethanol produced from 300 million bushels of grain was produced in 60 manufacturing facilities located in 22 states. Ethanol blended fuels are currently marketed in 42 states, with several states such as Iowa, Nebraska, Kentucky, Illinois, and Indiana, all with market penetration levels above 20 percent.

Consider these facts about ethanol in 1986 alone:

- 300 million bushels of corn were purchased to produce 750 million gallons of ethanol.
- Ethanol production raised farm income by $850 million.
- The National Corn Growers Association goal of 1 billion bushels of corn to ethanol by 1990 would add $3.6 billion to farm income.

- Federal farm program costs were reduced by nearly $600 million.

- Foreign oil imports were reduced by 1 billion gallons as a result of ethanol production.

- Ethanol is the most environmentally benign octane booster on the market today -- 10 % ethanol blends in gasoline reduce harmful carbon monoxide hydrocarbon tailpipe emissions by 25%.

In addition, the following ethanol fuel strengths are important to consider:

- Ethanol is a liquid fuel at a time when liquid fuel dependence presents the highest degree of energy vulnerability to the nation. The United States is still 97 percent dependent on oil as a mobility fuel. Transportation is the major bottleneck to reducing America's vulnerability to future oil supply disruption.

- Ethanol can be easily assimilated into the existing supply and marketing systems as an octane booster or as a fuel extender with gasoline.

- Ethanol's use as an octane enhancer to replace lead has been a key component of the industry's market growth. Because of Environmental Protection Agency (EPA) restrictions on lead use, the nation's refineries will face a 20 billion gallon alcohol-equivalent "octane gap" by 1990 and ethanol is expected to meet a significant share of that new demand. By positioning itself against the more expensive and environmentally harmful octane enhancing additives that are derived from depletable resources, renewable-based ethanol will become more competitive in the gasoline marketplace. Increased ethanol use at the refinery reduces the amount of energy needed in the reforming process. Crude oil imports are thereby reduced on more than a 1.2:1 basis and further contribute to energy security.

- The raw material, grain, is domestically produced, as is the fuel, and if levels of production continue as predicted during the next ten years, will be readily available. New, less expensive cellulose or waste materials are being researched as possible future feedstocks for ethanol production. These technologies are very promising and may be available well before production reaches the 2 billion gallon level.

- Ethanol production does not compete with food production. Ethanol production at the 2 billion gallon per year level will not affect feed grain exports. Exports of both bulk corn and other coarse grains coupled with processed high-protein ethanol co-products will be available in world markets at competitive prices. The promise of new conversion technologies and supplemental ethanol feedstocks additional to corn could provide the option of both feed and fuel at levels of ethanol production far greater than those existing today.

- Production can be decentralized and under the proper conditions scaled down without unacceptable economic penalties. Decentralized development also addresses this important security concern: movement away from the type of centralized energy production and distribution system that can be easily and systematically disrupted.

- New capacity can be added reasonable quickly -- under some scenarios, this could be beneficial when facing oil supply cut-offs of more than 12 months.

- The ethanol industry provides a net balance of payments benefit. These gains continue at least up to the 2 billion gallons capacity level -- assuming no technological improvements -- without significantly increasing corn prices. With 2 billion gallons of ethanol production in 1990, net gain from co-product exports could be about $1 billion per year.

- Compared with gasoline, there are no major environmental problems associated with ethanol production. The ethanol industry's contribution to clean air is demonstrated by a 25% reduction in harmful carbon monoxide tailpipe emissions from ethanol enhanced gasoline.

With expansions to existing facilities, and new facilities brought on line during 1986, domestic ethanol capacity has increased to approximately one billion gallons per year. While in 1978, blends of 10% ethanol and 90% gasoline were largely marketed by independent gasoline marketers, now over thiry-five refiners are currently marketing ethanol-gasoline blends across the United States.

Over the last seven years, ethanol blends have won consumer acceptance as a gasoline additive. Ethanol blends are approved under the warranties of _all_ 19 domestic and foreign automobile manufacturers marketing vehicles in the U.S. In 1986, in order to help alleviate fuel injector system clogging caused by the high olefin content in some hydrocarbon gasolines, the domestic fuel ethanol industry initiated a program, at the request of the nation's largest automobile manufacturer, to add a detergent package to ethanol to help prevent the formation of deposits on port-fuel injectors and to keep carburetors clean.

Federal and State Support for Alcohol Fuels

The U.S. Congress and many states have taken significant steps to encourage the production and use of fuel ethanol. The Federal policy supporting alcohol fuels is consistent with Federal policy aiding the commercialization of other energy technologies, such as hydroelectric, solar, nuclear, and petroleum. Since 1978, Congress has provided a range of financial incentives to stimulate the commercialization of fuel ethanol and has also enacted legislation to reduce regulatory burdens which might impede the development of the fuel ethanol industry.

These incentives were established by Congress and the states to enable ethanol blended fuels to be competitive with regular and premium grades of gasoline in the marketplace, and to assist the development of an emerging new alternate fuels industry. Since 1978, Congress has provided a variety of tax incentives for mixtures of gasoline and alcohol as well as straight alcohol fuel. Present law provides gasoline containing at least 10% ethanol a six cents per gallon exemption from the nine cents Federal excise tax on gasoline until December 31, 1992.

The new tax reform bill signed by the President last year once again reaffirmed federal government support for ethanol enhanced fuel by maintaining all current tax incentives for ethanol, as well as extending the energy investment tax credit for biomass for two years.

In addition, both the Senate and the House have recently voted to maintain the partial exemption from the federal excise tax for ethanol enhanced gasoline as they approved measures designed to reauthorize the Highway Trust Fund. The Congress has reexamined and reaffirmed its support for the continuation of the ethanol excise tax exemption every year since 1981.

These incentives were fashioned in recognition of ethanol's ability to help provide a market for surplus agricultural products, reduce crude oil imports, and improve air quality by serving as an alternative to lead and aromatics such as benzene.

Today, the production of ethanol is considered one of the most significant new market opportunities for our abundant grain surpluses. Ethanol is regarded as an environmentally benign gasoline octane booster capable of reducing dangerous carbon monoxide and hydrocarbon tailpipe emissions. Ethanol enhanced gasoline blends are included in air quality control strategies being formulated by metropolitan areas across the nation that have yet to meet their federally mandated Clean Air Act carbon monoxide attainment objectives. Finally, ethanol is the most promising liquid fuel alternative available to help reduce our growing dependence on foreign sources of crude oil and gasoline.

ETHANOL INDUSTRY OVERVIEW.

The domestic fuel ethanol industry strongly believes that after the first six years of the ethanol industry's commercial development, there is sufficient evidence of its effectiveness and impact on various sectors of our economy for the Congress to make an informed judgement on its contributions to national objectives.

Any evaluation of the U.S. fuel ethanol industry is necessarily complicated by the fact that it is an exceptionally complex industry, which combines many different dimensions and crosscuts a variety of interests. The failure to accurately identify all of the components of fuel ethanol production and use, and to fully measure the many benefits that come together in a unique way, would mean substantially understating the industry's value. At a time when the Congress is confronted with the increasingly difficult challenge of deciding what is or is not cost effective for the taxpayer, it is especially important that the Senate Finance Committee has access to all the information regarding how fuel ethanol impacts agriculture, energy, environment and health; refinery and transportation policy; R & D; and national security, just to name a few. The fuel ethanol industry is confident that the record established during its fiest six years of commercial development will withstand this rigorous cost/benefit assessment, and welcomes the opportunity to make known its views for the record.

I would like to focus on what the domestic fuel ethanol industry regards as the major dimensions of fuel ethanol's impact on the economy and federal budget. I believe it is not an overstatement to claim that fuel ethanol production and use is a unique activity that is best demonstrated by evaluating its agricultural; energy security; and environmental benefits.

I. AGRICULTURAL BENEFITS. Unlike any other liquid fuel alternative available in the forseeable future, fuel ethanol is uniquely derived from a wide range of renewable feedstocks. Today, U.S. fuel ethanol production technology utilizes such diverse feedstocks as grain, cheese whey, citrus wastes, and forestry residues. However, by far the predominant feedstock used by the industry's 100 production facilities is corn. As such, the U.S. fuel ethanol represents an already important-- and major -- new domestic market for our nation's corn producers.

Ethanol's agricultural benefits are many; however, I would briefly like to cite three of its primary benefits:

1. Fuel ethanol provides a desperately needed new domestic market for U.S. agricultural production at a time when conventional markets, including export markets, are stagnating or even declining;

2. Ethanol not only provides a new outlet for America's most important commodity export -- grain -- but also adds value to it. The ethanol manufacturing industry helps the U.S. shift away from simply becoming a bulk exporter of raw commodities, while allowing for the creation of jobs and investments in the U.S. which otherwise might be going overseas. These ripple effects help to strengthen the currently depressed agricultural sector, which accounts for 25% of the U.S. GNP.

3. Ethanol establishes the foundation for a shift away from policies that achieve supply/demand balances through non-production land idling, to policies dictated by a strong domestic market for U.S. grain. This "market enhanced" approach benefits farmers, consumers and taxpayers and should be a top priority for agricultural policymakers.

I would like to briefly respond to two misconceptions about fuel ethanol's agricultural impacts: First, contrary to the contention of its detractors, fuel ethanol can simultaneously benefit farmers, consumers, and taxpayers; and Second, there is not a "food vs. fuel" tradeoff. Due to ethanol's demand side stimulus, commodity prices can be increased over time in a way that substantially increases net farm income, reduces taxpayer exposure, and yet has a negligible impact on the consumer's food bill. Several studies of the fuel ethanol industry have found that one billion gallons of ethanol production annually would mean an increase in net farm income of over $3.5 billion. As a result of the additional 400 million bushels of corn disappearance, prices would rise 25-40 cents a bushel, thus significantly reducing government deficiency payments to producers (even a few cent increase that lifts the market price over the loan rate, times the number of bushels of eligible corn production, would save taxpayers hundreds of millions of dollars), loan supports, and surplus storage costs.

The "food vs. fuel" issue has, for all practical purposes, been totally discredited. The starch alone in the renewable feedstock is transformed into a valuable liquid fuel and octane enhancer, and the protein, vitamins, and minerals are transformed into a more easily transported and stored feed material. The apparent competition between food and fuel is based on the assumption that any crop used to produce significant amounts of ethanol is entirely diverted from the production of food. All of the grain's original protein content, together with the protein-rich yeast that proliferates during the fermentation, remains in the residual mash known as "distillers' dried grains" and is sold domestically and in foreign markets as a protein-rich livestock-feed supplement. Only the starch portion of the grain is used to produce the ethanol.

II. ENERGY BENEFITS: The U.S. is now importing 42% of its energy needs, resulting from a 22% increase in oil imports during 1986. This is a sharp rise in oil imports, from 4.9 mmbd to 6mmbd, leaving the U.S. more dependent on imports than at any other time since 1980. Some petroleum industry sources feel that if this trend continues, the U.S. could rely on crude oil imports for over 50% of its current consumption in four years. In just one year Saudi Arabia moved from the fifteenth to the second largest supplier of crude oil to the United States.

Since the oil price collapse in February of 1986, our domestic oil production has declined, our consumption has increased, and we are now importing much more oil.

- Average imports of crude oil and petroleum products during the past month have been about 7 million barrels per day, compared to 4.7 million barrels per day for the same period a year ago.
- Our present import level is over 40% of our domestic consumption, compared to 27% a year ago, and 37% in 1973. Many analysts are predicting that this could increase to a level between 50 and 60% of our consumption in the 1990's, assuming that oil prices do not increase substantially from current market levels.
- The effect of lower oil prices on U.S. oil companies has been dramatic. Spending on domestic exploration and development by the large integrated oil companies during the second half of 1986 was about 44% below the level for the same period in 1985.
- This drop is reflected in the rig count. The number of active drilling rigs in the U.S. recently has fallen to 761. That compares to almost 1,137 last year at this time, and about 4,500 rigs in operation in December 1981.
- Employment in the U.S. oil recovery and refining industry is down 35% -- 264,000 jobs in the last year.
- Domestic oil production has fallen 300,000 barrels per day in the last twelve months.

Long-term Projections

1) API's recent survey of oil companies: domestic crude production will fall from 8.9 MMB/D in 1985 to 6. MMB/D in 1991, assuming a sustained real price of $15 per barrel (in 1985 dollars).

2) Energy Information Administration: domestic oil production will fall to 7.2 MMB/D in 1990, and 5.0 MMB/D in 1995, assuming real prices of $17 per barrel in 1990 and $20 per barrel in 1995.

3) Conoco's "Energy Outlook Through 2000", domestic crude oil production will fall by 2.5 percent per year, from 8.9 MMB/D to 6 MMB/D in 2000, assuming oil prices between $15-20 pe barrel through 1990 and rapid increases thereafter.

4) U.S. oil imports could more than double from their current level of 7 MMB/D to at least 15 MMB/D in 1995, according to API.

According to the U.S. Census Bureau 1986 Import data, U.S. crude oil imports finished second behind passenger cars in dollar value. Crude oil imports (including fuel and gas) cost the U.S. $37.6 billion last year. The U.S. is also relying more on imports to satisfy its growing demand for finished gasoline. In 1986 the U.S. imported 5.7 billion gallons of unleaded gasoline at a cost of $2.6 billion. This new trend has caused one major refinery to shut down. Derby Refining Company suspended operations at its El Dorado, Kansas plant due to the fact that "excessive" imports of crude oil and refined products have dirven prices down to an "inadequate" level. The company says it can buy refined products from foreign sources at prices that permit it to maintain adequate profit levels.

In the past six years, fuel ethanol has proven beyond any doubt that it qualifies as an exceptional high grade liquid fuel extender and octane enhancer. From 1980 to 1986, U.S. motorists will have driven more than 500 billion trouble-free miles on ethanol enhanced fuels, making ethanol the most significant liquid fuel alternative in the commercial marketplace.

Contributing to the growing demand for ethanol enhanced fuels is the fact that all major automakers recognize ethanol-blended fuels under their performance warranties (a fact which distinguishes it from other fuel alternatives).

In 1986, fuel ethanol displaced the equivalent of over 21.4 million barrels of imported crude oil. It is important to realize that ethanol is itself an already refined, high value component that serves as an excellent motor fuel octane enhancer. In fact, a growing number of experts argue that ethanol's value is far above that of finished gasoline, since the addition of 10% ethanol to 90% gasoline results in an average 3-number increase in the fuel's octane level. According to numerous studies and refinery experts, ethanol is superior to the other commonly mentioned options for octane improvements in terms of both octane blend values and cost per octane barrel of improvement (when the tax incentives are considered).

Another very important dimension of ethanol's energy role is its excellent capability to displace oil by virtue of its combined displacement and energy savings effect. Relative to other oxygenates, an Ethyl Corporation analysis found that ethanol was by far the most significant displacer of crude oil in part because it also allows the refiner to reduce his energy losses caused by high severity reforming.

III. ENVIRONMENTAL BENEFITS: Based on ethanol's ability to boost octane, ethanol has played a significant role as an alternative octane enhancer to toxic lead. On March 4, 1985, EPA promulgated stringent regulations requiring refiners, blenders, and importers to drastically reduce gasoline lead usage by 91% in order to meet a 0.1 grams per leaded gallon (gplg) lead standard effective January 1, 1986, and an interim lead content standard of 0.5 gplg effective July 1, 1985. At the current time, ethanol blends which account for 8% of the U.S. gasoline market are displacing the octane equivalent of 4 billion grams of lead. (One gallon of alcohol is equivalent to approximately 5 grams of lead in terms of the level of octane boost achieved.)

While refiners have historically used tetra-ethyl lead as the cheapest means of increasing the octane of gasoline, the phasing out of lead from leaded gasoline as well as the switch to unleaded gasoline, has required refiners to find alternatives to boost the octane of gasoline. While refiners have a number of options for meeting EPA lead standards such as refining gasoline at increased severity, constructing or expanding existing mechanical processing equipment, and until 1988, buying lead rights, refiners can also increase octane by :

1. adding more butane and pentane which have already raised fuel volatility substantially and created serious ozone pollution problems.

2. adding more aromatics such as benzene and toluene produced during the crude oil refining process. However, these aromatics have increased serious health and environmental side effects, or

3. purchasing high-oxygen blending components such as ethanol.

The Environmental Protection Agency has recognized ethanol's role as an alternative octane enhancer. As part of its regulatory analysis accompanying the Lead Rule, EPA estimated that 50,000 barrels per day of ethanol would be used to replace lead in addition to other refinery options for meeting EPA's lead phasedown standard. While ethanol fuel will not supply refiner's total octane needs, ethanol and other high oyxgen blend stocks are playing a role in aiding refiners to bridge the octane gap created by EPA's lead restrictions.

In addition to its benefits as an alternative octane enhancer to tetra-ethyl lead, ethanol fuel has also played a significant role by helping to reduce harmful air pollutants such as carbon monoxide (CO) and exhaust hydrocarbon (HC) emissions. Although the addition of 10% ethanol to gasoline generally increases the volatility of the resultant blend up to one pound per square inch (psi) RVP, 10% ethanol blended fuel also results in major carbon monoxide exhaust emission reductions in most cars on the road. Because ethanol contains oxygen, it burns cleaner than gasoline. Studies conducted by EPA, the Colorado Department of Health, the Coordinating Research Council, and the California Air Resources Board have all demonstrated carbon monoxide reductions on the average of up to 20-25% in exhaust emissions with the use of 10% ethanol blended fuel. Because of these environmental benefits, Colorado, New Mexico and Arizona are considering a mandatory ethanol blend program in their State Implementation Plans to significantly reduce carbon monoxide levels.

Conclusions:

Mr. Chairman, the domestic ethanol industry was established in response to a public policy demand from our government to reduce our dependence on foreign sources of energy. With the creation of a partial exemption from the federal excise tax on gasoline and a commitment from the government that the production and marketing incentives would remain in place for 12 years, over $2 billion in private sector resources have been invested in the construction of 100 ethanol production facilities. The domestic ethanol industry respectfully requests that you reject the Administration's budget proposal to repeal the ethanol excise tax exemption.

Ethanol is a proven, high performance gasoline additive capable of providing higher octane levels, reduced carbon monoxide pollution from automobiles, increased farm incomes and enhanced energy security.

Thank you.

Senator BAUCUS. Thank you, gentlemen.

Mr. Burhop, what do you think Congress should do with the Airport Trust Fund? That is, what increased or new expenditures should there be and how should they be paid for? I know part of the debate is over whether user fees should go for capital improvements in the system; some support this approach; others say general revenues should be used.

A separate question is, apart from the source, just how much should we boost, say, Air Traffic Controllers or the construction of runways or radar at various airports, and so forth?

Let me go back to the first question: What is your view on the degree to which some of these capital improvements should be paid for out of general revenues, apart from user fees?

Mr. BURHOP. The Air Transport Association believes that virtually all capital improvements should come from the Airport and Airway Trust Fund as opposed to the General Fund. There is more of a dispute as to how much operating expense, the O&M account at FAA, should come from the General Fund as opposed to the Trust Fund. There, we think that 85 percent of the O&M costs should come from the General Fund.

But on capital improvements for the Airport and Airway System, virtually all of those should come from the Trust Fund, for which it was originally set up back in 1970.

Senator BAUCUS. Are you basically saying that we should not reauthorize the extension until we know what we are going to spend?

Mr. BURHOP. That is exactly right.

Senator BAUCUS. So I am asking you, what, in your view, should we spend?

Mr. BURHOP. As far as expenditure amounts, we have—in testimony before Senator Ford's Aviation Subcommittee and on the House side—recommended significant increases in the Facilities and Equipment Account, which buys the equipment like computers to make the system run more efficiently, to fund the NASS plan, which I mentioned in my oral statement.

We also would significantly increase the amount of money spent for the Airport Improvement Program, including things like noise abatement, but also more money to build runways, to build taxiways, fast exit ramps, and so forth, to make the airport side of the system run more efficiently so that more aircraft could be used in the system on a daily basis.

Senator BAUCUS. But do your recommendations involve an amount that is less than, equal to, or more than the current rate of collection of user fees?

Mr. BURHOP. Less than the current rate of collections including interest. There would still be a strong surplus there based on our expenditures.

Senator BURHOP. So, if your recommended expenditures were enacted, the fund would still have a surplus that would be greater than the previous surplus?

Mr. BURHOP. Not greater than, no; it would maintain about its current level.

Senator BAUCUS. Then equal to?

Mr. BURHOP. That is right.

Senator BAUCUS. My point is that the income into the fund would equal, basically, your recommended expenditures?

Mr. BURHOP. That is right, more of a balance there, correct.

Senator BAUCUS. To be specific, it would equal your capital expenditures and 20 percent of the O&M expenditures.

Mr. BURHOP. But basically we are suggesting that the entire ATC system be taken out of the FAA, funded through a portion of the current user fees, and that realignment would require significant consideration by the two jurisdicational committees, which would then put a different demand for taxes or user fees on the two revenue committees.

So, we don't think that the two revenue committees ought to decide on what tax levels to build into assumptions of the Budget Committee or for other purposes until the Ford Subcommittee has determined what structure needs funding.

Senator BAUCUS. Mr. Vaughn, more precisely what effect would repeal of the exemption have on price? As I understand it, now the ethanol industry pays three cents of the nine cents?

Mr. VAUGHN. That is correct.

Senator BAUCUS. So that is a six-cent differential. More precisely, explain the effect that the full nine-cent rather than the three-cent fee would have on the ethanol industry? Gasoline prices go up and they go down, but that's six cents out of a total of some 90 cents average, I would guess, for gasoline at the pump.

Mr. VAUGHN. For the ethanol industry, the cost of production goes up as well, and down. Our feedstock cost, grain—if you could predict for us grain prices over the next three years, I could give you ethanol prices, priced out for the next three years.

The key factor there for the ethanol industry is that we have invested over the last six years not just in the construction of facilities but in the construction of very efficient plants and operations, and investments in new technology such as various yeast strains that help produce higher quantities of ethanol. Out of a bushel of grain four years ago we were getting approximately 2.3 gallons per bushel; today the industry average is creeping toward 2.6; so you are getting a dramatic decrease in the cost.

But ethanol is marketed by most major gasoline marketers today as a gasoline extender. The gasoline price in the Gulf today is about 53 cents a gallon, unleaded. Our cost of production is approximately twice that today in the industry. Without the six-cent exemption bringing our cost, if you will, down to the blender, they will not purchase our product as a gasoline extender.

We are becoming more competitive every day in the business as an octane-booster. Now many of the blenders today are using us for the full 3-octane points, but again wanting us to compete with gasoline. So, that six-cent exemption is something that the industry doesn't receive, but the gasoline blender receives. It makes that product an acceptable cost-effective product, and he will go out and purchase that product. Without the exemption, ethanol sales more than likely wouldn't exist.

Senator BAUCUS. How do you answer Mr. Willis's point that you are still users. If there is some incentive for ethanol, it should come out of some other pot and shouldn't come out of the Highway Trust Fund?

Mr. VAUGHN. I will probably surprise him and tell him that I agree with him. Our industry has taken the position—in fact, we were very active in the extension and also the increase from four to five cents to the nine-cent gasoline tax, because we see the need.

I don't think the debate is between do we need better highways and more secure bridges or do we want cleaner air, increased energy security, enhanced agricultural benefits for our farmers—that is not the debate. The debate is: How do you reimburse the trust fund, or at what source does ethanol receive some kind of support from the Federal Government?

Senator BAUCUS. What is the answer to that? If not the trust fund, where?

Mr. VAUGHN. In fact, very recently—I would like to hear them say it publicly; we keep hearing things privately from people at OMB—they tell us now that they agree with us, that they finally have read GAO reports and other documents that essentially state that the ethanol industry, from the Federal Government's perspective, is at worst a wash. Essentially we save as much money on the USDA's side as we spend, or we don't collect for the Highway Trust Fund.

The reimbursement proposal is an excellent one. How we could enforce that or reimburse the trust fund is something we as an industry have pledged to work with the Highway Users Federation and the various organizations in trying to accomplish that goal.

I don't know the answer to that question—it is a very complicated one, at best.

Senator BAUCUS. Senator Daschle?

Senator DASCHLE. Thank you, Mr. Chairman.

Mr. Burhop, I would like to clarify something in the statement that you made in regard to the trust fund itself. You indicated on page two that the trust fund had a cash balance of $8.6 billion and an uncommitted balance of $4.3 billion. What is the difference between the uncommitted balance of 4.3 and the cash balance of 8.6? That difference, I assume, by definition, is that the other portion of the $8.6 billion is committed, but what are the commitments made to?

Mr. BURHOP. The largest single expenditure from that difference would be the dollars which FAA has already contracted to spend for the purchase of equipment for the National Aviation System Plan, the plan that was adopted by Congress three or four years ago, which was the next big step to make the system more efficient, to bring on state-of-the-art computers and so forth. That would be the single biggest expenditure from that amount of money.

Senator DASCHLE. And with respect to the remaining $4.3 billion in so-called uncommitted funds, have those funds been used in recent years for general revenue purposes?

Mr. BURHOP. No, sir. We see them as a ripe plum for the plucking, but, no, they have not been.

Senator DASCHLE. They have not been at this point?

Mr. BURHOP. That is correct. They are assumed to be used to balance the budget in numbers, but the money has been maintained in the Aviation Trust Fund.

Senator **Daschle**. And this trust fund has generally been funded through the user fees that we have already established, and would not necessarily be enhanced by the user fees the Administration is currently proposing?

Mr. **Burhop**. That is correct. They would be enhanced in the sense that, if the numbers requested by the Administration for expenditures did in fact become outlays, and the request for tax levels, as requested by the Administration, did in fact become the tax levels for the next number of years, then that surplus would continue to grow at a significant rate.

Senator **Daschle**. I think your proposal for a Federal Aviation Authority is an excellent one. I would only ask, just for the record, whether there is an analogous authority in some other country at this point? Does any other country do it like you are proposing here?

Mr. **Burhop**. No. Coincidentally, two or three other countries are looking at this structure for their own uses but, to my knowledge, no country has a similar structure today. There are of course numerous other federal corporations within the government today—TVA, the Postal Service, and about a dozen other ones—that exist in a very analogous form to what we are suggesting.

Senator **Daschle**. And in terms of the number of user fees required, or the amount of user fee revenue required, to fund such an authority, would it be more or less than currently being imposed?

Mr. **Burhop**. Based on the assessment that we did, and an outside organization under contract to ATA, it is our view that current tax levels, revenue levels, would be sufficient to maintain both the FAA and this new federal structure.

Senator **Daschle**. Thank you, Bill.

Mr. Willis, you made your case against the exemption for ethanol from the user fees for the Highway Trust Fund. Would your organization publicly support a subsidy in place of a tax exemption?

Mr. **Willis**. For the ethanol?

Senator **Daschle**. Yes.

Mr. **Willis**. We don't really see a problem with the ethanol concept as a savings or an effort to reduce our dependence on foreign oil. Our problem with it is the way it relates to the highway program.

Senator **Daschle**. What I am asking is, since you see the exemption for ethanol as a drain, understandably, on the Highway Trust Fund, would you support some other form of assistance for the ethanol industry in place of the Highway Trust Fund exemption, the tax exemption?

Mr. **Willis**. Yes, sir.

Senator **Daschle**. You would support that?

Mr. **Willis**. Yes, sir, if it were done within the confines of the Department of Agriculture, the Department of Energy, or in a nature like that, yes, we would.

Senator **Daschle**. And would you support such a subsidiy in an amount comparable to the positive impact the tax exemption is currently having on the ethanol industry?

Mr. **Willis**. Certainly. Yes, sir.

Senator **Daschle**. Very good.

Well, I appreciate your willingness to support such a subsidiy. I think that is what we need. Obviously there is going to be a time in the future when we are going to have to make some kind of a transition, and the sooner we can get organizations like yours on board calling in unison for something other than what we have today, the sooner I think it can be accomplished, and the more productive the industry will be as a whole. So I am glad to hear that, and I thank you for your testimony.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator, and thank you, gentlemen, for your testimony. Some of you have come great distances. I want to thank the other panelists, too.

The hearing is adjourned.

[Whereupon, at 10:54 a.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

AMERICAN BUS ASSOCIATION
1025 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036 (202) 293-5890

Norman R. Sherlock
President and
Chief Executive Officer

STATEMENT OF NORMAN R. SHERLOCK
PRESIDENT AND CHIEF EXECUTIVE OFFICER
THE AMERICAN BUS ASSOCIATION
ON THE REVENUE PROPOSALS IN THE PRESIDENT'S FISCAL 1988 BUDGET
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF
THE SENATE COMMITTEE ON FINANCE
MARCH 24, 1987

On behalf of the American Bus Association, I appreciate this opportunity to comment on the revenue options proposed in the President's fiscal 1988 budget and I commend the Committee for conducting this hearing.

In its fiscal 1988 budget proposal, the Reagan Administration has outlined a number of revenue raising proposals, including the repeal of all existing highway excise tax exemptions. These exemptions are applicable to excise taxes imposed on the sale of diesel fuel, gasoline, gasohol, lubricating fluids and tires. These exemptions, particularly the 12 cent per gallon diesel fuel excise tax exemption, are critical to maintaining a financially healthy and viable intercity bus industry as part of the national transportation network.

Congress has repeatedly expressed its support for the transportation policy goals embodied in these exemptions as evidence by the rejection by the very same proposal last year. For these and the following reasons, the American Bus Association urges that Congress again reject the proposal to repeal these exemptions.

Historically, Congress has urged the use of private intercity bus transportation. The Energy Tax Act of 1978, the Highway Revenue Act of 1982, and the Tax Reform Act of 1984 all contain provisions exempting intercity buses from all or part of the diesel fuel excise tax and from other highway user taxes.

Most recently, Congress acted to extend these exemptions as part of P.L. 100-17, the Highway Reauthorization Act. During consideration of the reauthorization act, the House and Senate tax writing committees considered the question of repealing or reducing these exemptions in order to raise revenue for highway and transportation programs. They decided that there was no need to take this step for either revenue raising or tax equity reasons.

This approach stems from congressional recognition that the intercity bus industry plays a unique and vital role in our nation's transportation system. Additionally, Congress has recognized that private intercity bus operators must compete with subsidized mass transit operations and other subsidized forms of transportation for tour and commuter passengers.

The Office of Management and Budget estimates that the repeal of all existing highway excise tax exemptions would yield $800 million in increased receipts to the Highway Trust Fund in fiscal 1988. In regard to exemptions extended only to the bus industry, the Congressional Budget Office estimates that repeal would yield actual additional revenues of only $100 million in fiscal 1988. Further, CBO estimated last year that the elimination of exemptions for the private intercity bus industry only would provide only a small portion of that figure -- approximately $30 million. Clearly, the excise tax exemptions extended to the intercity bus industry are not large revenue losers when measured in terms of the federal budget.

More than 375 million passengers ride intercity buses annually. In comparison with other modes of transportation, intercity buses carry far greater proportions of senior citizens, students, military personnel, and women. An income profile of intercity bus passengers reveals that 58 percent of our passengers have annual family incomes of less than $15,000.

Of the approximately 14,000 points in the United States served by intercity bus service, an estimated 13,000 are not served by any other form of intercity transportation. Based on this information, it is clear that repeal of the diesel fuel excise tax exemption for intercity buses would disproportionately impact rural communities and low income socio-economic groups.

We also wish to draw attention to the energy conservation incentive provided by the diesel fuel excise tax exemption. Intercity buses are the most fuel efficient form of intercity travel based on passenger miles per gallon of fuel consumed. To the extent that people can be encouraged to utilize intercity bus transportation rather than driving personal automobiles, energy conservation is achieved. The excise tax exemption allows intercity bus operators to offer low fares which are an alternative to more energy intensive forms of transportation. It should be noted that the intercity bus is roughly three times more fuel efficient than Amtrak and six times more fuel efficient than commercial air transport.

Travel and tourism businesses rely heavily on the intercity bus industry to bring them business and for many of those businesses, it is a critical lifeline. A ten percent decrease in bus ridership would cost these businesses close to $1 billion in revenue annually. As a further result, unemployment would increase dramatically, particularly among minorities, women and youth who are heavily employed by travel and tourism entities.

These exemptions are the only subsidies which the intercity bus industry receives from the federal government. However, the intercity bus industry must compete with other modes of transportation which receive huge federal subsidies. Specifically, intercity bus operations must compete for passengers with Amtrak and the airlines. Amtrak is directly subsidized at a rate of approximately $35 per passenger. The airlines are subsidized at a rate of approximately $9 per passenger, but have enjoyed larger subsidies and favorable tax treatment in past years. Last year, the Administration estimated that the current 12 cent per gallon diesel fuel tax exemption amounted to an indirect subsidy of only 8 cents per passenger for the intercity bus industry.

Additionally, the repeal of these exemptions would further harm the competitive position of the private intercity bus industry vis a vis public transit authorities. Public transit authorities are increasingly competing with private bus companies on commuter routes and in charters and tours. They enjoy tax exemptions due to their status as governmental entities and also receive subsidies from the Federal government. This subsidy, enacted as part of the Surface Transportation Act of 1982, has provided public mass transit authorities with revenues equal to 1 cent of the per gallon tax on motor fuels. Through this arrangement, publicly-owned systems have received more than $1 billion annually from taxes imposed on private highway users, including private intercity bus companies. The proposed repeal of these exemptions would place our industry at a greater disadvantage than ever before.

The repeal of these exemptions, in conjunction with the effects of deregulation in the industry as well as continuing liability problems, would have a devastating financial impact on the intercity bus industry. Many intercity bus operators are small business people and could not withstand the financial burden that will fall upon them if forced to begin paying those excise taxes from which they are currently exempt.

For the reasons stated in this testimony, the American Bus Association urges the Committee and the Congress to reject the Administration's proposal to repeal these excise tax exemptions.

AMERICAN COUNCIL ON EDUCATION

Division of Governmental Relations

March 21, 1987

The Honorable Max S. Baucus
Chairman
Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the American Council on Education and the associations listed below, we hereby request that this letter be included in the record for your Subcommittee's hearing on March 23 on the revenue increases proposed in the Administration's FY 88 Budget.

The Administration's FY 1988 Budget proposes to repeal the 48-year-old law providing that the Social Security (FICA) tax is not to be levied upon wages earned by students from jobs provided by the college or university they attend. Far from ending any statutory anomaly, or closing an unjustified gap in program coverage, the proposal overturns an important and longstanding policy. The revenues that would be added to the Social Security Trust Fund are relatively insignificant, but the amounts in question would impose major financial burdens on needy students and college aid programs, which seem not to have been anticipated or considered by the Administration.

Background

Since 1939, Section 3121(b)(10) of the Code has provided that the FICA tax shall not apply to a student's earnings from a job provided by his or her school, college or university.[1] This policy has been based on the understanding that such student jobs are quite unlike the arms-length relationships that characterize most employment in the economy. Rather, most school-provided student jobs are means by which a college or university furnishes financial aid or designs its fellowship and work-study packages. Few student jobs pay wages much exceeding the minimum wage. The great majority are part-time (10-20 hours per week) and last only during the academic year. Most are awarded on considerations taking into account student financial need and/or merit.

Students and schools unquestionably enjoy some benefit from the fact that these jobs are not subject to the same FICA tax as virtually all other jobs. But the law has always considered that, for nonprofit educational institutions and needy students, this short-term benefit is by no means an unfair advantage. To impose a tax of nearly 15 percent on these jobs would seriously burden needy students and reduce financial aid and fellowship and scholarship programs throughout the nation. Most students who hold these

---

[1] Section 3121(b)(10) of the Code defines "employment," for the purpose of the FICA tax, not to include "service performed in the employ of . . . a school, college or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college or university."

One Dupont Circle, Washington, D.C. 20036-1193 (202) 939-9355

jobs work because they cannot otherwise afford to pay for their education. A reduction of at least 7 to 15 percent in their income will be a heavy blow. Similarly, the Administration proposal would have the effect of slashing college and university operating funds as well as financial aid resources by big amounts. To implement this proposal together with the Administration's recommendations to curtail federal financial aid to students would necessarily deny educational opportunity to hundreds of thousands of students.

Discussion

The Administration's proposal ignores the considerations underlying the FICA policy of nearly a half century's duration.

The Administration argues that the original purpose of the existing exemption to protect schools from the administrative burdens of withholding and paying taxes on the wages is obsolete due to the automation of institutional records. But for many schools -- particularly smaller institutions -- the removal of the exemption would impose real and substantial burdens. More important, however, would be the impact on college operating funds, financial aid, scholarship and work-study programs. For example, the University of California alone calculates that, under the Administration proposal, it would have to pay $12.8 million in employer contributions during FY 1987 and its students would have to pay the same amount in employee contributions. From that one institution, in other words, more than $25 million would be diverted from student financial assistance. The University of Michigan and its students would lose more than $5 million.

The Administration also asserts that its proposal would provide important protection for a segment of the public -- students -- not now covered by Social Security. But most students remain dependents of their parents and do not earn enough from their part-time student jobs to qualify for coverage. A smaller, not greater, proportion of today's students than those in the past are married with children; in most of these cases, the student has a working spouse or holds a full-time job and attends school part-time. Almost all students are fully covered by university healthcare programs and have no need for medicare (assuming the dubious proposition they could qualify). We are aware of no study concluding that students could achieve any genuine benefits from paying Social Security tax on their part-time school-provided jobs. The Administration does not suggest that it has ever studied the question and we are certain that the conclusions of such a study would not support the Administration's proposal.

Conclusion

By contrast with the major effect the Administration proposal would have on students and institutions of higher education, its revenue contribution to the Trust Fund would be trivial in relative terms and cannot be justified on the grounds of current or projected revenue need.

Nor should part-time student jobs be placed in the same category as various loopholes in program coverage that have been the subject of attention in recent years. Student jobs are temporary, of several years' duration at most, after which the student joins the labor force and can be expected to make his or her fair share of contributions over an entire working lifetime. Higher education no doubt increases Social Security revenues by increasing the wage base on which graduates are taxed. Student jobs do not present the situation in which a whole segment of the economy participates in an alternative to the Social Security system that undermines the objective of universal coverage. It is merely a short delay in participation that serves to increase the participant's capacity to contribute in the long run.

In the final analysis, the Administration proposal is unnecessary from the standpoint of program revenue needs. It ignores that part-time student jobs are more in the nature of financial aid/work study benefits than regular employment compensation. And the effects of the proposal are potentially devastating. It would curtail substantially the resources available for financial aid. Many students may lose the chance for an education. Others might scrape by through heavier borrowing, adding to the student debt-burden problem that justifiably is causing increasing alarm throughout the country. The students themselves will derive no real tangible benefit from the proposal. And we believe that, by reducing the numbers of students who can afford to obtain degrees, the proposal would ultimately reduce the amount of contributions to the Trust Fund.

We urge the Subcommittee to reject this proposal.

Sincerely,

Sheldon Elliot Steinbach

Sheldon Elliot Steinbach
General Counsel

cc: Members of the Subcommittee

The following associations join ACE in this statement:

American Association of Community and Junior Colleges
American Association of State Colleges and Universities
Association of American Universities
Association of Catholic Colleges and Universities
Association of Jesuit Colleges and Universities
Association of Urban Universities
Council of Independent Colleges
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges
National Association of Schools and Colleges of the United Methodist Church
National Association of Student Financial Aid Administrators

STATEMENT BEFORE THE TAXATION AND DEBT MANAGEMENT SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE ON EMPLOYER FICA ON TIPS

PRESENTED BY THE

AMERICAN HOTEL & MOTEL ASSOCIATION

1819 L STREET, N.W., #600

WASHINGTON, DC 20036

(202) 223-6872

On behalf of the membership of the American Hotel & Motel Association, we appreciate the opportunity to offer testimony on requiring employers to pay FICA tax on employee tips to the Taxation and Debt Management Subcommittee of the Senate Finance Committee.

The American Hotel & Motel Association is a federation of hotel and motel associations located in the fifty states, the District of Columbia, Puerto Rico and the Virgin Islands. The Association has a membership of over 8,800 individual hotels and motels which represents approximately 1.28 million rentable rooms. Inclusive in our membership are all of the major hotel and motel chains. However, the majority of our members are smaller properties. Based on 1985 figures, the lodging industry employs on the average 1,400,000 people with an annual payroll exceeding $12.2 billion. In addition, the lodging industry pays over $4.1 billion in federal taxes annually. In 1985 alone, the lodging industry created over 100,000 new jobs.

The lodging industry generated over $42 billion in sales in 1985 with approximately 25% of that total or $10.5 billion generated by food sales and 9.5% or $4 billion generated by beverage sales. This combined total of $14.5 billion represents sales which may have generated tip income for tipped employees of hotels and motels. While many factors affect the percentage tip which may be received in a particular situation, if we were to apply, for example, a rate of 8% as is done in IRS Tip Allocation Regulations, that percentage would have generated total tips on food and beverage sales of $1.16 billion in 1985. The employer portion of Social Security tax on that figure for our industry alone would be a staggering $83 million for 1985.

In his recently released budget document, the President included a proposal requiring employers to pay the so-called "employer portion" of the Social Security payroll tax on total tips received by employees. The President's budget predicted receipts of $200 million for this line item for fiscal '88. We are opposed to this targeted tax increase.

An Administration witness testifying recently before the Senate Finance Committee on this proposal called the current system a "quirk in the law". A review of the legislative history of the 89th Congress enacting the amendments to the Social Security law subjecting tips to employee FICA shows that serious consideration was given to this question by both the House and Senate. The decision that was reached to have only the employee pay Social Security tax and to pay only at the employee rate, was a compromise position reached in the Conference on the 1965 Amendments to Social Security (Rept. No. 682, 98th Congress, 1st Session).

An effort to tax both employer and employee at the applicable rate as the President now proposes was rejected in that Conference. In rejecting an employer's Social Security tax on employee tips, the Conference Report states "Thus, tips are not considered as remuneration for employment for purposes of the employer taxes..."

During that Congress, the Senate passed legislation requiring employees to pay Social Security taxes on tips at the self-employment rate. While we agree that this would be the appropriate tax treatment in light of the nature of tips, we have no desire to see the employee pay higher FICA taxes at this time, because we reject the concept of any present increase in Social Security tax.

The simple truth in the above quotation from the Conference Report, that tips are not wages, was obviously a significant reason for exempting the employer from FICA on tips. That fact has not changed today -- tips are not wages. They form no part of the payroll of the employer. Payroll has always consisted of amounts actually paid as wages by the employer to the employee and over which the employer has exercised full control. This control is necessary to allow the employer to determine the total payroll that can be afforded, and to plan in advance to meet the necessary payments for salaries, fringe benefits and all state and federal taxes related to payroll. If Congress obligated an employer to make a FICA payroll tax payment on tips, the employer would be unable to control the maximum amount attributable to payroll. In addition, the employer would have no way of knowing in advance the amount of the liability for such a tax and would be denied the opportunity to plan for and schedule such payments.

To take monies given to an employee by an unrelated third party and create a liability for an employer based on such amounts defies logic and common sense. The Congress showed great wisdom in 1965 when it determined the method of assessing FICA on tips. That method works because it accurately identifies tips as what they are: non-wage income flowing from employment. The fact that tips are income flowing from employment makes it appropriate to subject the employee to FICA on these amounts. The fact that these amounts are not wages, not in any way paid or controlled by the employer, makes it appropriate to exclude the employer from payment of FICA on these items. It is bad legislative policy to disturb a FICA tax on tips merely to obtain an increase in general revenues. This does an injustice to the Social Security system and such tinkering should be flatly rejected.

It is common knowledge that the recent amendments to the Social Security law restored solvency to the system. The System now is a "pay-as-you-go" system running in the black. This condition of solvency is projected to run well into the 21st Century. In simple words, Social Security does not need additional money. Under the current system, beneficiaries paying FICA tax on tip income receive full benefits. Causing the employer to pay the proposed additional amounts in no way enhances the Social Security benefits receivable by tipped employees. Revenues raised under the banner of Social Security would become part of the general revenues.

With any monies flowing from an employer FICA tax on tips not benefitting the Social Security system or any class of beneficiaries the question arises what has the Administration proposed.

The answer is evident, a tax increase, plain and simple-- targeted at the lodging/restaurant industry. This contradicts promises from the Administration and Congress that tax increases would not follow on the heels of the Tax Reform Act of 1986. We call on Congress not to do indirectly what it has promised not to do directly. The lodging industry, in particular, felt the pain of Tax Reform last year. It suffered and will continue to suffer along with many other industries. Now our industry is being targeted again by employer-paid FICA on tips for an additional tax payment that may exceed $80 million annually. This is not only unfair, it is unnecessary.

There is an additional word of caution. It seems clear that the ultimate payor in this scheme may be the consumer. With the employer having no control over or access to tips, if he is required to pay the FICA tax on tips, these payments will directly reduce the profit of the business. This loss may be passed on to the consumer in an amount sufficient to pay not only the FICA tax but the income tax on the revenue increase. In the alternative, if the practice of imposing a service charge becomes more prevalent the consumer may pay even more because history shows us that when a service charge is imposed many still continue to tip. This directly increases the cost to the consumer.

We call on the Senate Finance Committee to reject the lure of the "subsidy" argument and see the current assessment of FICA on tips as the fair, correct and equitable way to determine that liability. No modification is needed.

GOVERNMENT FINANCE
OFFICERS ASSOCIATION

1750 K STREET, N.W.
SUITE 200
WASHINGTON, D.C. 20006
202 429-2750

April 7, 1987

The Honorable Max Baucus
United States Senate
SH-706 Hart Senate Office Building
Washington, DC 20510

Dear Senator Baucus:

Reciprocal intergovernmental tax immunity is a constitutional doctrine which the Administration proposes to violate by repealing the exemption of state and local governments from the payment of federal highway excise taxes. The Government Finance Officers Association (GFOA) strongly objects to this proposal and urges the Congress to reject it as an encroachment on our system of federalism.

State and local governments do not tax the federal government's use of their roads and streets or consumption of fuels. Repeal of the exemption from such federal taxes is nothing short of another expensive federal mandate on states and localities. Estimates from around the country illustrate the annual fiscal impact of this proposal:

Fullerton, CA	$ 63,000
Tulsa, OK	182,000
Allegheny County, PA	52,000
Windsor, CT	22,700
Inver Grove Heights, MN	4,600

These are not costs we can reduce. They are a function of delivering essential services such as police and fire protection, and school transportation which we are responsible for providing. Cost cutting measures to accommodate the loss of the excise tax exemption would seriously reduce the level and quality of these services. Moreover, in the majority of local jurisdictions the bulk of these services are provided using nonfederal highways.

State and local governments understand the need to balance the federal budget. Over the last few years we have seen federal assistance dwindle while mandates on state and local governments have grown. We have responded by meeting our citizen's needs through constant fiscal changes. Office of Management and Budget Director James Miller said it is time to stop the "free-ride" of state and local governments on federal highways. We would remind the Administration that the federal government is exempt from paying excise taxes for the use of roads built with state and local funds.

EXECUTIVE OFFICE: 180 NORTH MICHIGAN AVENUE • SUITE 800 • CHICAGO, ILLINOIS 60601 • 312 977-9700

We appreciate the opportunity to comment on the Administration's tax increases contained in the proposed fiscal year 1988 budget. The GFOA is a professional association with over 10,500 members who are state and local government finance specialists. Our members are the financial managers of the nation's states, cities and counties and are gravely concerned over the shifting of costs from the federal government to states and localities. Therefore, the GFOA stands in firm opposition to levying highway excise taxes on state and local governments and urges the Congress to recognize the major impact on the quality of services such a proposal would have on all our citizens.

Sincerely,

Betty Jo Harker

Betty Jo Harker
Director of Finance
Ames, Iowa

President
Government Finance Officers
Association

Enclosure: Policy

Government Finance Officers Assoication

Policy Statement

Repeal of Exemption From Highway Excise Taxes

Historically state and local governments and the federal government have reciprocally exempted each other from paying excise taxes. The GFOA has long supported the immunity of state and local government from taxation by the federal government. Under current law the federal government taxes the fuel consumption, truck and tire sales, and highway use of non-governmental users. Respecting the longstanding doctrine of reciprocal tax immunity state and local governments and the federal government do not levy gasoline, sales, or road use taxes on each other.

In its proposed fiscal year 1988 budget the Administration recommends the repeal of the exemption from federal highway excise taxes of state and local governments. This provision is an encroachment on state and local governments by the national government and it imposes a significant financial burden on state and local governments. Accordingly, the GFOA opposes this tax on state and local governments and calls for congressional rejection of this proposal.

Approved: Executive Board, February 27, 1987
Recommended for aproval by the GFOA Membership

TESTIMONY OF
ROBERT D. DUNCAN
ENGINEERS & ARCHITECTS ASSOCIATION
(A MEMBER OF THE COUNCIL OF ENGINEERS AND SCIENTISTS ORGANIZATION)

Presented To The
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT COMMITTEE ON FINANCE
FOR THE HEARING HELD ON

MARCH 23, 1987

I appreciate the opportunity to submit written testimony in opposition to extending Medicare coverage to employees working for the City of Los Angeles. The Engineers and Architects Association represents over 5,000 engineers, scientists, allied technicians, administrators and attorneys in the City of Los Angeles. The Association is also a member of a larger organization called the Council of Engineers and Scientists Organization (CESO) which represents a number of other associations such as ours on a national basis throughout the United States.

We are revisiting this issue once again after it was passed by the 99th Congress through the Reconciliation Bill (COBRA) that Medicare would be phased in by employees hired on or after April 1, 1986 by contributing 1.45% of their salalries. The employees hired before April 1, 1986 feel jilted now that mandatory coverage is being reconsidered. They thought the issue of their inclusion was resolved by the gradual phase-in of mandatory coverage. This "roller coaster" effect plays havoc with the lives of over 40,000 employees in the City of Los Angeles, not to mention the 5 million employees throughout the United States currently uncovered. For all practical purposes this phase-in philosophy will eventually cover, with less hardship, all the employees in America. With our leaders in government discouraging tax increases, mandatory Medicare coverage is an immediate 1.45% tax increase to uncovered employees. This is why mandatory coverage for new hires softens the effects of this tremendous hardship.

However, the main issue for the labor organizations is the disruption of our collective bargaining process. The City has a formalized labor/management process much like the National Labor Relations Act in the private sector. Labor contracts are negotiated for over 40,000 employees in the City of Los Angeles. If our management failed to follow the negotiated labor contracts a great deal of labor unrest would result. However, labor and management have no control over Federal legislation once it has passed. We are obligated to reopen our labor contracts to comply with the law. In the case at hand this mandatory coverage issue would unsettle years of negotiations between labor and management over salaries, medical plans, and pension plans.

As for the financial problems the immediate combined effect to the City of Los Angeles and the employees will be over 40 million dollars. If the County of Los Angeles and its employees are included the combined effect is nearly 100 million dollars of lost revenue to the County, the City and their respective employees!

One final thought and I will close. The City employees are dedicated to serving the citizens of Los Angeles by designing, implementing, and maintaining systems that turn on switches for electricity, open faucets to use water, provide sanitation through sewers and storm drains, collect discarded refuse, and provide streets for travel, etc. Mandatory coverage will be a revenue loss to state and local governments at a time when there is a decrease in Federal appropriations and loss of revenue sharing.

STATEMENT OF THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS SUBMITTED FOR THE RECORD OF THE SENATE COMMITTEE ON FINANCE REGARDING THE ADMINISTRATION'S PROPOSAL TO REPEAL STATE AND LOCAL GOVERNMENT EXEMPTIONS FROM HIGHWAY EXCISE TAXES

MARCH 20, 1987

The National Association of Towns and Townships* (NATaT), on behalf of more than 13,000 small governments nationwide, is pleased to present its views on the Administration's proposal to raise revenues through additional tax sources. Our testimony specifically focuses on the plan to eliminate the present state and local government exemptions from federal excise taxes on motor fuel, tires and heavy vehicles.

There are 39,000 general purpose local governments in the United States. Seventy percent of these serve less than 3,000 people. While township officials appreciate the need to create additional tax revenues, we do not believe it is appropriate to do so on the backs of small communities where this proposal would fall the heaviest. The policy discriminates against small rural governments which, by their very nature, spend a greater percentage of their budgets on fuel consumption.

---

* The National Association of Towns and Townships (NATaT) is a non-profit membership organization offering public policy support, education services and technical assistance to over 13,000 towns, townships, and small communities across the United States; vital members of the federal-state-local government team. Surprisingly, these small governments represent the majority of all general purpose governments across America. Few people recognize that nearly two-thirds of all such governments represent populations under 3,000; NATaT member communities are typical of those governments and typical or the dedicated local officials who take time from their regular jobs to volunteer as a service to their friends and neighbors in the community.

Most importantly, the National Association of towns and Townships believes the Administration's proposal:

1. creates a system of double taxation requiring citizens to pay federal taxes on public services supported almost exclusively with local tax dollars;
2. unfairly increases the burden on financially hard pressed small local governments which have already lost the most in federal retrenchment efforts;
3. incorrectly assumes that the additional tax dollars would be proportionately returned to those communities from whence they came; and
4. needlessly frustrates the federal/local partnership to meet public service demands.

We believe that the Administration's proposal should receive careful attention from the Congressional Budget Office (CBO) which, by federal statute, is required to conduct cost estimates on proposals effecting state and local governments. Analysis under the "Local Government Cost Estimates Act" would clearly show that this proposal would: 1) place a significant cost burden on local governments; and, 2) is biased against small governments which can afford it the least. Town and township officials urge the Committee to reject any proposal to repeal these exemptions.

DOUBLE TAXATION

Citizens residing in small rural areas currently pay federal gas taxes--9 cents for gasoline and 15 cents for diesel fuel. They pay excise taxes on tire and heavy equipment. In fact, the Bureau of Labor Statistics states that consumers from rural areas spend more per household on gasoline and motor oil than their urban counterparts.

This makes sense when one considers that people residing in rural areas travel greater distances for consumer goods and essential services. Generally, public transit is greatly limited or non-existent in these remote areas where individuals rely almost exclusively on the private motor vehicle. Consequently, citizens in the nation's small towns and cities presently finance more than their fair share through tax payments to the Highway Trust Fund, money which, ironically, goes almost exclusively to an Interstate system connecting urban centers and isolating small communities. It must be recognized that even now, rural citizens, through their contributions to the Highway Trust Fund, are thus contributing to their own demise.

Repeal of local government exemptions would add insult to injury, asking small town America to add to this disaster by paying an even greater share of the burden by taxing local tax dollars! Our nation's citizens pay local taxes expecting that those dollars will be spent to maintain local services. They do not expect local tax dollars to go to Washington; they pay federal taxes for that purpose. Citizens of small communities cannot build roads ont he interstate system while their own bridges and roads continue to deteriorate and their emergency delivery systems decline.

UNFAIR BURDEN ON FINANCIALLY HARD-PRESSED RURAL COMMUNITIES

Last year, Congress saw fit to terminate the General Revenue Sharing program. With its termination, 80 percent of America's localities lost their only source of federal assistance. Yet the pressures of federal mandates can still be felt on local budgets. These mandates place demands on our capital and operating costs.

While all local governments wrestle with meeting these rising needs, small communities have even greater difficulty. They are more likely to be economically depressed. Because of state limitations, they generally have no hope for any revenue diversification. Most local governments rely almost exclusively on the real property tax. But in areas already economically hard-pressed, raising property tax rates--assuming the state-imposed cap has not been reached--produces no real additional income, because people simply cannot afford to pay. Citizens and governments in rural areas alike, are struggling to survive--in spite of federal government efforts to the contrary.

Between 1980 and 1985, federal aid to state and local governments was cut by 24 percent. The loss of general revenue sharing makes this figure even higher. According to U.S. Treasury figures, local governments will have to set aside 6.7 percent of their limited tax dollars to make up for the loss of GRS. In more rural states, the percentage is even higher. In North Dakota, for example, the percentage is 12.3 percent, and in West Virginia it rises to 22.2 percent. The nation's rural towns and small communities have taken the brunt of federal efforts to reduce domestic spending. Now 80 percent of all American localities receive no federal aid at all.

New proposals such as the one being considered by your committee asking them to take an even greater blow is more than unfair. This bias toward small communities pushes these small governments--to the breaking point. The most accessible government to the people could very well end up being the government least able to meet service demands.

The Federal Highway Administration (FHwA) estimates that the elimination of the excise exemption will provide an additional $415 million from the motor fuel tax alone. In relationship to the overall federal budget, this us a minute amount, Yet, compared to the increase in local government operating costs vis a vis their own budgets, the amount is quite significant.

Aurora Township, Illinois would pay another $3,420 in increased fuel costs for its road and bridge department and its senior citizens Dial-a-Ride program. In Atchinson County, Missouri, the county would pay an additional $4,000 in fuel for its highway department, alone. Adding fuel costs for sheriff and patrol cars, ambulance and other public vehicle use, the county costs would increase to over $18,000 a year. While $18,000 may not seem like a great deal of money in Washington, D.C. terms, it would pay for the construction of one and one-third new bridges in small town America! Of the 147 bridges located within this Missouri county, 117 are structurally deficient. In Atchinson County terms, $18,000 could go a very long way.

For those townships where the costs would be under $1,000 or $2,000 or $3,000, it may seem like an insignificant amount, but relative to the fiscal situation in small communities these small amounts may comprise 5-15 percent of their local budgets.

FUNDS SHOULD RETURN TO LOCAL AREAS

Last September, Federal Highway Administrator Ray Barnhart told the Senate Finance Committee that he reasons for the elimination of the exemption was "to charge the users of the highway system for their actual use." This statement makes absolutely no sense.

Federal Highway Trust Fund dollars are not presently allocated in terms of where they are generated. Rural citizens who on a household basis pay more in excise tax on motor fuels do not receive more transportation funds than their urban counterparts. To assume that rural governments would receive any monies through the highway trust fund insults the intelligence of the hardworking, dedicated local officials in small communities around the country. To sell the proposal based on this faulty premise is even more disturbing.

According to the office of Transportation in the U.S. Department of Agriculture, there are over three million miles of rural roads in the U.S. Rural roads account for more than 80 percent of the total U.S. mileage.

Since rural communities have the largest responsibility for the country's transportation system, and since consumer reports show that rural residents consume more in motor fuels, it seems logical that rural areas should receive the greatest amounts of trust fund resources. But according to USDA's Office of Transportation, 80 percent of the rural road system is not eligible for federal funding because of the way states categorize roads.

In fact, FHwA reports in Highway Statistics 1984 that 96.8 percent of Federal Highway Trust Fund receipts flowed to state agencies and the District of Columbia, while only 1.4 percent was given to counties and townships. Municipalities received only 1.7 percent. (See Attachment A.)

States have allocated highway funds with the lion's share obligated to the interstate system. By and large, states have disbursed these funds to serve the more urbanized areas first; the primary road system received the next largest share. Since 1980, funds appropriated to the interstate system have increased. The chart below shows the steady climb.

FHwA APPORTIONMENTS BY PERCENTAGE

	Interstate	Primary	Secondary	Urban
1980	56.4%	23.4%	8.2%	11.9%
1981	55.8%	24 %	8.6%	11.5%
1982	6 %	20.7%	6 %	12.1%
1983	63 %	21.1%	7.3%	8.9%
1984	62.9%	22.8%	6.7%	8.3%
1985	63 %	22.8%	6.3%	7.8%
1986	63 %	23.5%	23.5%	7.4%

While statistics show that rural areas account for the majority of traffic--or annual vehicle miles of travel--in many states, rural roads do not receive comparable percentages. Using AVMT as the criterion, rural roads are not fairly funded in 40 percent of the states. Considering truck mileage on rural roads, the distribution is even more inequitable. Sixty percent of the states under funded. The chart provided as Attachment B clearly shows the funding bias toward small communities and rural areas.

It is clear that the greatest wear and tear on the nation's transportation system falls on rural communities. The concept that the excise tax on tires, heavy vehicles and motor fuels defrays the costs of repair for that wear and tear clearly does not wash. It is unthinkable to force hard-pressed towns and small communities to pay taxes on the basis that these dollars would be returned when we know the system if presently incapable of doing so.

THE PROPOSAL FRUSTRATES FEDERAL/LOCAL PARTNERSHIP EFFORTS

States, counties, small towns and cities are all partners with the federal government in meeting public service demands. Our officials are all elected by the same people. Our tax dollars are collected from the same pot. We should be able to work together. The Administration's proposal does not take into account the special relationship between federal, state and local government.

According to the Congressional Research Service's January 2, 1986 report entitled "The Effect of Federal Tax and Budget Policies in the 1980's on the State-Local Sector," exemption of federal real property from state and local taxation cost state and local governments $4 billion in 1982. Federal exemption on securities cost states and localities another $2 billion. Statistics for 1986 would show even larger amounts of lost revenue. In fact, the report states that "the maximum revenue loss from all provisions in 1982 amounted to about $6.8 billion."

Local governments do not tax the federal government. Payments made under the Payments in Lieu-of-Taxes program (PILT) program do not cover the actual costs of maintaining, under PILT the property exempted under the tax. In fact, this program has been earmarked for elimination in the past.

While counties receive a modest payment under PILT, small cities, towns, and other governmental units do not receive any reimbursement for lost tax dollars.

Yet the Administration sees no reason why local governments should not pay an excise tax. Perhaps local governments should assess the federal government of the true costs of removing military establishments, public national parks, and the like from the local tax rolls. The partnership may be more even-handed. The $6.8 billion lost to the local government could go a long way towards helping state and local governments meet the rising costs of local service demands.

CONCLUSION

The National Association of Towns and Townships urges the committee to reject any proposal which eliminates the state and local government exemption from federal excise taxes. We do not believe that it is appropriate policy to expect citizens to pay this tax twice, first for their own consumption and secondly, for that in meeting their governmental needs. Local tax dollars should not be sent to Washington as excise taxes, particularly on items as essential as motor fuel and tires. Local tax dollars should stay in those local communities where they can do the most good.

This statement clearly shows how this policy proposal would discriminate against rural communities nationwide. These same communities have already born the brunt of national deficit reduction efforts. To ask them to take on the additional burden of paying federal taxes for public services is unrealistic, unfair and extremely unwise.

Finally, before the Congress makes any decision to repeal these exemptions, NATaT urges the Committee to seek cost estimates from The Congressional Budget Office in accordance with the provisions of the State and Local Government Cost Estimates Act." Township officials are confident that thorough research will show that this proposal would cause a significant burden on small town America. The communities can ill afford to bear this additional burden.

ATTACHMENT A

RECEIPTS

FEDERAL HIGHWAY TRUST FUND RECEIPTS -- By Collecting Agencies - 1984

	Amount --millions--	Percent
State Agencies and D.C.	$9,972,000,000	96.8%
Counties and Townships	$ 148,000,000	1.4%
Municipalities	$ 179,000,000	1.7%
	$10,299,000,000	

RESPONSIBILITY

EXISTING PUBLIC ROAD AND STREET MILEAGE - 1984 - by Jurisdiction

	Rural	Urban	Total	Percent
State Control	817,813	102,968	920,781	25.4
County/Township Control	2,012,434	140,817	2,153,251	74.5
Other Local Roads*	121,054	428,975	550,029	

*Includes mileage not identified by administrative authority

Source: Highway Statistics 1984, DOT/FHwA

ATTACHMENT B

	Rural Car/Truck Mileage			Rural Large Truck Mileage		
States	Funding for rural roads	percentage of mileage	difference	percentage of mileage	difference	Average Difference
Kentucky	39.2%	58.9%	−19.7%	69.3%	−30.1%	−24.9%
Georgia	31.4	49.2	−17.8	75.0	−43.6	−30.7
Mississippi	46.7	64.3	−17.6	71.6	−24.9	−21.2
South Carolina	46.8	64.3	−17.5	62.4	−15.6	−16.6
Minnesota	36.6	51.2	−14.6	74.2	−37.6	−26.1
Pennsylvania	32.9	46.2	−13.3	55.0	−22.1	−17.7
Rhode Island	4.0	17.0	−13.0	21.1	−17.1	−15.1
New Jersey	8.3	18.5	−10.2	25.6	−17.3	−13.8
Oregon	46.1	55.2	− 9.1	65.5	−19.4	−14.3
Ohio	34.9	43.9	− 9.0	56.7	−21.8	−15.4
Arizona	43.3	51.2	− 7.9	52.3	− 9.0	− 8.5
Alaska	56.7	63.9	− 7.2	70.0	−13.3	−10.2
Virginia	44.5	50.9	− 6.4	58.5	−14.0	−10.2
Maryland	26.7	33.0	− 6.3	40.4	−13.7	−10.0
Connecticut	17.6	23.7	− 6.1	Data Not Available		− 6.1
New York	23.9	29.1	− 5.2	Data Not Available		− 5.2
Alabama	48.9	52.2	− 3.3	61.5	−12.6	− 8.0
Kansas	53.8	56.7	− 2.9	66.9	−13.1	− 8.0
Delaware	42.4	45.0	− 2.6	51.5	− 9.1	− 5.9
Illinois	30.8	31.8	− 1.0	49.9	−19.1	−10.1
Washington	41.4	41.2	0.2	43.8	− 2.4	− 1.1
Michigan	40.3	38.6	1.7	45.2	− 4.9	− 1.6
Arkansas	67.8	65.8	2.0	75.4	− 7.6	− 2.8
Nebraska	66.8	64.2	2.6	74.9	− 8.1	− 2.8
Texas	46.5	38.4	8.1	61.3	−14.8	− 3.3

National Conference of State Legislatures

444 North Capitol Street, N.W.
Suite 500
Washington, D.C. 20001
202/624-5400

President Irving J. Stolberg
Speaker
House of Representatives
Connecticut

Executive Director
Earl S. Mackey

STATEMENT FOR THE RECORD

HON. KAREN MCCARTHY

STATE REPRESENTATIVE

MISSOURI HOUSE OF REPRESENTATIVES

ON BEHALF OF

THE NATIONAL CONFERENCE OF STATE LEGISLATURES

SUBMITTED TO THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

SENATE COMMITTEE ON FINANCE

REGARDING

MARCH 23, 1987 HEARINGS ON

REVENUE PROPOSALS IN THE PRESIDENT'S BUDGET

APRIL 13, 1987

Denver Office: 1050 17th Street • Suite 2100 • Denver, Colorado 80265 • 303/623-7800

My name is Karen McCarthy. I am Chair of the Ways and Means Committee of the Missouri House of Representatives and Chair of the Federal Budget and Taxation Committee of the National Conference of State Legislatures.

I am submitting for the record the position of the National Conference of State Legislatures regarding several of the tax increases proposed in the President's budget. The three items that I have chosen to address are the repeal of the highway excise tax exemption for state and local governments, the immediate extension of Medicare coverage to all state and local employees, and finally, the proposed inclusion of railroad workers within state-federal unemployment insurance programs.

1. Repeal of Exemption from Highway Excise Tax

In its attempt to give the appearance of no new taxes on individuals, while raising revenues to reduce the deficit, the Administration offers a proposal that would impose a direct tax on state and local governments. Calling the excise tax a "user fee" does not make it acceptable. Under a strict "user fee" concept, would states be entitled to tax federal vehicles for the use of streets and highways maintained by states?

Treating state and local governments as simply commercial enterprises, rather than as full partners in providing services to our shared constituencies, undermines established principles of reciprocal tax immunity and federalism. This proposal contradicts the commitment to federalism announced by the Administration's Working Group on Federalism.

To shift the federal deficit to state and local governments while causing them to increase taxes to maintain the same level of services is, at the least, hypocritical. We serve the same taxpayers.

Roads across the country have been financed by fuel and transportation taxes for eighty years. The Highway Trust Fund, begun in 1956, is built on the foundation of dedicating transportation revenues to transportation needs. The long-standing exemption for state and local governments is based upon the recognition that states and localities contribute in other important ways to maintaining the nation's network of streets and roads.

The expressed intention to include these revenues within the Highway Trust Fund, while nominally reducing the deficit, is justifiably met with skepticism by state and local governments. If the money from the Trust Fund were all earmarked for expenditure--as it should be--then there would be no net federal revenue gain to contribute to reducing the federal deficit.

A sound transportation system is vital to our nation's competitive position; turning to the trust fund to finance the general deficit could lead to an uncertain destination and jeopardize our infrastructure.

Because of the dubious validity of the stated reasons for imposing this tax on state and local governments, we might conclude that this proposal is actually the start of yet another assault on state and local treasuries.

NCSL applauds the Congress for extending the exemption in revenue provisions of H.R. 2, the Highway Bill, and trusts that any reckless attempt to deviate from the dedication of transportation funds will be curbed.

2. Extension of Medicare Coverage to All State and Local Employees

With its proposal for mandatory Medicare coverage for all employees of state and local governments, the Administration violates the agreement to a gradual phase-in of coverage for all newly hired employees on or after April 1, 1986 reached in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) by the Administration, Congress and the states.

In this attempt to raise revenue for deficit reduction, the Administration will be reneging on its promise of a tax reduction to low and middle income Americans by increasing the Medicare payroll tax on at least 4 to 5 million Americans employed by state and local governments. The immediate Medicare tax on employers would also seriously jeopardize the fiscal integrity of at least the 10 states that currently have the highest percentage of non-covered employees: Alaska, California, Colorado, Illinois, Louisiana, Maine, Massachusetts, Nevada, Ohio and Texas.

In addition, the Administration's revenue estimate does not take into account the diminishing number of state and local employees outside of the Medicare system since COBRA. Nor does the Administration's revenue estimate consider the cost of bringing 4 to 5 million Americans into Medicare as future beneficiaries.

3. Railroad Unemployment Insurance

Finally, the Administration again seeks to merge railroad workers into the state-federal unemployment insurance program. As we have testified in previous years, NCSL would support such a measure if there were a compelling reason to do so. No such evidence exists at this time. Both management and labor of the railroad industry reportedly continue to work within a mutual agreement regarding their unemployment and retirement systems.

If Congress were inclined to sanction a merger for minimal deficit reduction purposes, NCSL would urge that administrative grants for unemployment insurance be increased to accommodate obviously greater workloads; that state trust funds be reimbursed for benefits that result from wages paid prior to any merger; and that states be included in fashioning a gradual transition plan.

I stress the lack of any current need to effectuate a merger and urge you to resist the Administration's recommendations unless convincing evidence of need is forthcoming.

Thank you for your consideration in these matters.

LEGISLATIVE INFORMATION

STATEMENT

OF THE

NATIONAL EDUCATION ASSOCIATION

ON

EXTENDING MANDATORY MEDICARE COVERAGE

SUBMITTED TO THE SUBCOMMITTEE ON TAXATION
AND DEBT MANAGEMENT

OF THE

SENATE FINANCE COMMITTEE

APRIL 21, 1987

MARY HATWOOD FUTRELL, President • KEITH GEIGER, Vice President • ROXANNE E. BRADSHAW, Secretary-Treasurer
DON CAMERON, Executive Director (202) 822-7300

Mr. Chairman and Members of the Committee:

The 1.8 million-member National Education Association, representing public education employees throughout the country, urges this Committee to reject any proposal to force Medicare coverage on public employees who are not presently covered. In addition, we oppose the extension of mandatory Social Security coverage on uncovered public employees.

Mandatory coverage of school employees under Medicare would put a tremendous financial burden on school districts and would reduce the take-home pay of school employees. Given that Congress has already taken action to phase in all state and local employees, it would be a breach of faith with state and local governments and with public employees to now mandate coverage of current state and local employees.

When Congress created the Social Security/Medicare system, our members and other public employees were excluded from coverage. It was more than 20 years after enactment of the Social Security/Medicare system before state and local employees were provided an opportunity to elect to participate in the system.

Public employees excluded from Medicare and Social Security coverage worked at the state and local level to establish -- at great expense to employers and employees -- retirement systems that would afford health care coverage. Extensive state law has developed to assure that the benefits of public education retirement systems will be adequate and predictable far into the future.

Impact on State and Local Governments

After full consideration of proposals to impose mandatory Medicare on state and local employees all at once, Congress agreed to phase in Medicare coverage for all employees hired after April 1, 1986 through the Consolidated

Omnibus Budget Reconciliation Act of 1985 (COBRA). To now extend coverage to all public employees would be a breach of faith with state and local governments.

Mandatory coverage of school employees under Medicare would impose an immediate and severe financial burden on school districts and other state and local agencies. The cost of coverage for state and local governments is estimated to be $800 million in the first year, and $1 billion thereafter, with an equal amount paid by employees. Moreover, the costs of coverage would increase as salaries increase.

Schools and other state and local agencies do not have the resources to absorb the added cost of Medicare coverage for noncovered employees. Many states and localities are already hard-pressed to meet operating budgets, and they would be forced to reduce services -- including education programs -- to meet the sudden, dramatic costs of coverage. The alternative to cutting services would be to raise taxes. However, some 14 states and a number of localities have already raised taxes in the past three years.

The devasting demand this new fiscal burden would create would exacerbate a number of factors which have severely limited the ability of local governments -- including school agencies -- to maintain and improve services. Over the past six years, there has been a dramatic decrease in all areas of federal assistance to state and local governments including federal education programs. Other cuts in federal assistance to state and local governments, including the elimination of revenue sharing and the elimination of federal income tax deductions for state sales taxes, have put states and localities between a rock and hard place.

At the same time, state and local agencies have had to contend with tax limitations, including statutory or constitutional restrictions on increases in property taxes. Moreover, communities throughout the country -- particularly in areas where the economy is dependent on energy, agriculture, and manufacturing -- have experienced dramatic downturns in their economies which have further reduced revenues.

In short, the impact of this proposal on schools in affected states and communities -- in concert with other revenue restrictions, reductions, and economic setbacks -- would mean more than cuts in so-called frills. This proposal could, in many areas, result in the elimination of entire educational programs and staff layoffs.

Impact on Individuals

Today, some 600,000 NEA members concentrated in 14 states work in jobs not covered by Medicare. It is generally accepted that education employees, including certified teachers, are still paid far less than their counterparts in professions that require similar skills and training.

The salaries of education employees would be adversely affected in two ways. First, the average increase in payroll taxes for these lower and middle-income employees is estimated to be almost twice the average decrease in general income taxes under the Tax Reform Act of 1986. Second, with the large sums state and local agencies would need to pay this additional payroll tax, school districts and other government entities would not have funds to provide compensation increases, either for mere cost-of-living increases or to enhance incentives to attract and retain qualified school employees.

Given education reform efforts intended to upgrade standards or responsibilities for education employees, individuals would be asked to do more for less even at a time when they are being asked to do more with less.

Mandatory Medicare coverage would not result in improved benefits for most public employees. Employees in the noncovered states have established alternatives for health care coverage after retirement, often in connection with their retirement plans.

At a time when we need to create new incentives to attract and retain qualified individuals in education careers, the imposition of mandatory Medicare coverage with its resulting decrease in take-home pay would serve as a disincentive for persons to enter and remain in education professions.

Congress Has Rejected Coverage for Current Employees

In the last two sessions of Congress, the issue of extending mandatory Medicare coverage to current state and local employees was full debated, analyzed, and rejected. We recognize that Congress has a number of difficult choices in its effort to reduce the tremendous projected federal deficits and enormous federal debt. However, the answer is not to shift so severe a burden on a limited segment of the population. Vital public services including education, police and fire protection, and other services important to the health and safety of whole communities would suffer disproportionately from a proposal that would have only a neglible impact on the federal deficit.

Current law will, in short time, bring all public employees under the Medicare system. The turnover rate for state and local employees is about 9 percent a year. This gradual phase in will allow public employers to adapt to the change with careful budget planning, rather than throwing a monkey wrench into the operation of the affected states and communities.

We urge the Committee to reject any proposal that would mandate Medicare or Social Security coverage for current state and local employees.

Thank you.

○